104

OVERALL REVIEW OF SBA

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

WASHINGTON, DC, FEBRUARY 28, 1995

Printed for the use of the Committee on Small Business

Serial No. 104–13

U.S. GOVERNMENT PRINTING OFFICE

88–688 CC WASHINGTON : 1995

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-047619-4

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OVERALL REVIEW OF SBA

TUESDAY, FEBRUARY 28, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to notice, at 10:03 a.m., in room 2359-A, Rayburn House Office Building, Hon. Jan Meyers (chairwoman of the committee) presiding.

Chairwoman MEYERS. Good morning, ladies and gentlemen.

On January 6, I pledged to the Nation's small business community that our committee would hold a detailed set of hearings, which will include a program-by-program analysis of each and every program at the Small Business Administration. This morning is the first of those hearings. As it is the first, I asked the staff to arrange a hearing which would give the committee as broad an overview of the SBA as possible.

At today's hearing we will hear from three past SBA administrators whose tenure encompasses the era from the middle 1960's through the middle 1980's and the political attempt to entirely eliminate the agency. The Honorable Eugene Foley served both Presidents Kennedy and Johnson at the SBA. The Honorable Vernon Weaver ran the SBA under President Carter and also during that period oversaw the first White House conference on small business. The Honorable James Sanders served President Reagan at the SBA and withstood the political fire storm when there was a movement to eliminate the agency. Of course, he had the strength to do that because he is a Kansan. The committee will find that these three gentlemen have a great deal of wisdom to share with us as well as a tremendous amount of most refreshing candor.

Our final witness, who has worked with Mr. Weaver and others over the years, is the distinguished Barry Baldwin from London, England. Mr. Baldwin has been an instrumental force in the United Kingdom since the late 1970's in the restoration of small business in the economy and within the Government there. As everyone can see from his fascinating 91-point statement, he will present a very eloquent case of what can happen in a major industrialized nation when the Government makes no effort to aid, counsel, and assist small business.

This morning's hearing will give all the members an excellent opportunity to learn much about both small business and the SBA as well as the opportunity to question four superb experts in this field. We will start with you, Mr. Foley.

Mr. FOLEY. Thank you, Madam Chair.

Mr. HEFLEY. Madam Chairman.

Chairwoman MEYERS. Yes?

Mr. HEFLEY. Might I just make a brief statement before we get started with the witnesses?

Chairwoman MEYERS. Yes.

Mr. HEFLEY. I'm sorry to interrupt you because I know your testimony is a lot more important that what we have to say, but I do want to thank Mrs. Meyers for having this hearing and what I hope will be a series of hearings which examines the Small Business Administration and its viability and its need in the country.

In an era of a $200 billion deficit, it is important that we look at all areas of the Federal Government for savings. Now there is not anybody on this committee certainly, or probably anybody in the Congress, who would stand up and say that, "I'm not for small business." Of course we are for small business. I think the question we want to be asking in this next few weeks of hearings is: What does the Small Business Administration do to facilitate small business? This question came to me most dramatically, I think, when we had the administrator, the current administrator, of the Small Business Administration in trying to sell the Clinton health care plan, a plan that the small businesses I represent certainly didn't want, and I asked him the question: Do you represent small business? Are you there to facilitate small business, or are you there to facilitate the administration you work for? I think there is that kind of conflict, and maybe some of you can speak to that.

Last week I read an editorial by Rich Lowry in the Washington Times, and the editorial highlights the problems Virginia's Governor George Allen has had with his proposal to cut the State's budget. Quite frankly, he got shut out. What is remarkable is not that his entire package of cuts was tabled but, rather, the scope of the cuts that were rejected. Altogether, they affected just 1 percent of Virginia's total budget. I would suggest that Mr. Allen's experience is a good lesson for those of us in Congress who are determined to cut the size of Government.

Today this committee is beginning hearings on the future of the Small Business Administration. Simply put, there isn't one program in the Small Business Administration that doesn't have a constituency out there somewhere. That could almost be said for all the programs of Government. Wherever we raise the scalpel to cut, someone is going to yell ouch.

What is more troublesome is that many of those yelling in pain are the groups that traditionally line up for less taxes and limited Government. But those considerations shouldn't deter us from our task. If Republicans have the courage to cut wasteful welfare programs, we should have the same courage to cut wasteful business programs, and I guess that's part of the question we are asking, are there programs within the Small Business Administration that are wasteful, that simply don't work? The bottom line is very simple. The Federal debt is over $4 trillion. The Federal deficit is over $200 billion. Something must be done, and it needs to start this year.

Once again, Mrs. Meyers, I thank you for your leadership as chairman of this committee. This year already we have had the opportunity to hear from small businesses all across the country on

the issues that affect them directly such as tax reduction, excessive regulation, and Government mandates, and I look forward to the testimony of these witnesses and the others that we will have in the coming weeks.

Thank you very much.

Chairwoman MEYERS. Mr. Foley.

TESTIMONY OF HON. EUGENE F. FOLEY, FINANCIAL CONSULTANT, FOLEY AND ASSOCIATES, WASHINGTON, DC, FORMER SBA ADMINISTRATOR, 1963–1965

Mr. FOLEY. Thank you, Madam Chair.

Mr. Hefley, other members of the committee, Mr. Lynch, first of all I want to apologize for not having a full statement. I have prepared an outline of my testimony and I would request that it be made a part of my testimony and included in the hearing record. I have just returned from a business trip to Haiti and I am preparing to go back down to Haiti at the end of the week, and I just really, frankly, didn't have—because of the complexities of that business matter, I didn't have time to put together a full statement.

Second, I am going to direct my comments strictly to the 7(a) Program, the lending program. There are other programs in the SBA, and I'll let other witnesses talk about that, but the 7(a) lending guaranteed loan program is the one that the SBA is most known for around the country.

I don't want to be patronizing, but I do think that it is important that we share a frame of reference of common terms. To start from the basics, I want to explain the three types of capital that any business relies on. First, is equity, and that is investor money, the money by which one owns a part or all of a company.

The second is debt. That is what you go to the bank for; you borrow money; you try to leverage it. That is to say, you try to multiply your equity. Say you put in $10,000 and borrow $50,000; you have leveraged 5 to 1. That is a fairly high leverage factor, and, depending upon the management and the market, you may get turned down.

Third, there is a hybrid of both debt and equity, and that is, just to use a term that might stop conversation at a cocktail party, for instance, a convertible subordinated debenture. Now that sounds like a very complicated term, but it really isn't. A debenture is simply a long-term loan. Subordinated means that it is subordinated to all other debt. That is to say, in case of liquidation, other debts are paid before this one. Convertible means that the holder of the note can convert it to stock; in other words, convert it from a debt to an equity interest. Another form of hybrid is a note with warrant where you have a promissory note but you have the option to buy stock.

So, those are the three basic types of capital: Equity, debt, and the hybrids.

Now the uses of capital. Again, I don't want to be patronizing, but it goes back to the fundamentals of a balance sheet. As you know, we have assets on the left-hand side of the balance sheet, you have liabilities on the right. Assets and liabilities both are divided into short term and long term. Short term means, in the case of assets, cash or assets you own that are convertible to cash with-

in a 12-month period. Long term means anything over a year. Short-term liabilities are those debts that are coming due within a 12-month period. Long term are those that are over 12 months.

In terms of the uses of capital, working capital means the capital you need to finance the operations of the business for the next 12 months. It might be taxes, it might be administrative expenses, inventory, things of that nature.

Sometimes a company needs long-term financing for working capital. It could be a company is expanding faster than expected, has had a down period, too many of its assets are not easily convertible to cash, et cetera. The SBA's 7(a) Program makes this possible.

Fixed asset financing are long term: Land, machinery, building, and equipment, those assets that will be there for a long period of time, or at least over a year.

Now that distinction is important here because it gets down to the nature of the sources of capital. I won't go into detail on each one of these. The sources of capital are as follows:

One, public markets of course means the New York Stock Exchange, the American Stock Exchange, or NASDAQ, where a company can register its stock and have it traded to the public.

Two, private offerings means you go to institutions and/or to individuals where it is not registered, the stock is not liquid. That is to say, it is not tradable easily but there is a certain market for wealthy investors and institutions that would like to buy the stock of a promising company.

Three, I would like to expand a little bit on venture capital companies. Venture capital companies are companies that invest either equity or debt or very frequently a hybrid in risk situations. In talking about venture capital, I would like to talk about six rounds of financing to complete the background. That is, you have prestartup or seed capital; you have startup; that is, to start a business; then you have a first, second, third, and fourth stage of financing. First stage roughly means a company that has got a track record but is losing money. A second stage is a company that has a track record and may be making a little money. Third stage means that you are making a little bit more, and fourth stage is the final stage before going public; that is, before selling your shares on a public exchange.

The staff could get the exact figures. I can provide sources of information, but I would say, at the most, 10 percent of all venture capital financing are in the first three rounds; that is, prestartup, startup, and first stage; 90 percent of all venture capital is in stages 2, 3, and 4. I think that is generally not understood, and I think it is very important to understand.

Four, the hardest thing to raise money for is to start a company. Most of this comes from friends and relatives. It is kind of an informal network. There are a number of scholars who are trying to get a better fix on it. I am always amazed at how anybody starts a business, how they get the capital to do it, the tenacity to stay with it, but generally they get their startup money from friends and relatives. Later, if they succeed a little bit, then they might go to a venture capital company or to some other institution.

Five, insurance companies rarely lend or invest in small companies, very rarely. The reason being, they rarely make loans of less than $5 million, and they can't, not because they are mean or ultra conservative or anything like that. Their premium payments come in every day in large amounts, and it is much easier for them to make one $10 million loan than a hundred $100,000 loans. It is just the expenses of administration. So, you find insurance companies are unlikely to be a source of money for small companies.

Six, there are Government sources. Of course we are talking about one today, the Small Business Administration, the Rural Development Administration, the Department of Agriculture, there are several others. Various States have programs, and local communities, particularly in revolving loan funds where they get a grant from various agencies, Federal or State, and then they use that money to lend to local companies. Then as those payments go in, it goes back to the fund, and then they revolve it and lend it to other companies. So, that is a source. That is very important, primarily for smaller communities, to have a revolving loan fund, because it is tough to invest money in small communities. Let me explain why that is true.

Seven, there is a cost of administration of managing money. In a startup situation, venture capital companies have a rule of thumb that they don't invest in a company that is more than an hour's drive away from the office, and that is because a startup company has so many management, technical problems, market problems, that the investor wants to be right on top of it. If the investor has to go 6 or 7 hours or a plane ride away, it is too inconvenient, it is too costly, not in terms of money but in terms of management time.

So, small communities in smaller States—I would say, Madam Chair, in your State, I wouldn't think there is much venture capital in Kansas. I know my son lives in Montana, western Montana. It is very difficult to get a Los Angeles or a New York firm or Chicago or Minneapolis or a Denver firm to invest in Montana or the Dakotas or places like that. There are some, but not much.

Eight, one item left out by my typist here was number eight, commercial finance and factors. I should mention that because for certain industries like the garment industry that is a very important source of money. Let me explain what that is. One of the current assets that I was mentioning before is accounts receivable. That is, you make a sale but you don't collect the money for maybe 60 days. During that period of time prior to collection it is called an account receivable.

Nine, for small garment firms, they need that cash, so what they will do, they will go to a commercial finance company which will lend money and take the receivable as collateral, or they will sell the receivable at a discount, and that is a very important source of money for small companies; nine, leasing companies, of course they are leasing equipment.

Ten, finally, I want to get to the banks. One thing about banks and S&L's is, they are short-term lenders, I mean for less than a year, not exclusively but primarily, and they have to be, not again because they are conservative or mean, but their assets are short-term deposits and so they have to be short-term lenders.

If banks try to lend for all of their portfolio for 8 years, for instance, nobody knows what is going to happen. There could be a recession in the community, there could be a recession in the country, there could be a change in taste as to goods or services. It just is not wise banking policy, and the bank examiners won't permit banks to get too long term, so you have to realize that banks are primarily short-term lenders. There are some long-term loans, but you will see the statistics are—I think the average SBA loan is 11 years; 50 percent of all SBA loans are over 4 years; the average loan that a bank makes, not guaranteed by the SBA—and that is less than $1 million—is less than 4 years; that is the average.

So, what we are talking about here—and this gets to the heart of the matter—what the SBA does in its 7(a) Program is to make it possible for small- and-medium sized companies to obtain financing over a long period of time without giving up any ownership. Big companies can go to the public bond market for this. Small companies go to the SBA.

I do want to mention very briefly a summary history of the SBA. There was a predecessor agency called the Reconstruction Finance Corporation started by President Hoover in 1931, and that was designed of course to help counteract the ravages of the Depression. That program stayed in existence until 1953. That was not restricted to small business, and it had generally a good record.

President Eisenhower campaigned to eliminate the RFC. In 1953 the Eisenhower administration decided, rather than eliminate the RFC, they would restrict it to small business and continue the long-term financing because that was the only source of long-term financing available for small companies. So, they created the Small Business Administration, combining the long-term loan programs of the RFC with the Small Defense Plants Administration, which was a procurement assistance program during the Korean War. That became the Small Business Administration.

In 1964 when I was Administrator, we delegated the lending authority to the local level, to the district. Prior to that time, all loans were made in Washington, all loan decisions were made in Washington, and we delegated it because it cut the amount of time and brought in the local sense of what was going on in the community. They knew locally better than we did in Washington.

Related to that was the Guaranty Program. Prior to this, all loans were either a direct loan made by the Government or were what is called an immediate participation loan. That is, the Government put in some, the bank put in some. I changed that to a guaranty program where the bank put it all in and we guaranteed. Again, it cut some time in the whole program.

The statistics of SBA lending is roughly as follows: There are about 37,000 SBA loans made per year. When you compare that to the venture capital companies, plus the SBIC's, there might be 4,500 investments, so the SBA, in terms of the number of loans compared to the number of investments and/or loans made by the venture capital community, is far greater. There is just no other source of money for long-term financing.

In terms of money involved, the SBA is around $7.5 billion, the venture capital community maybe around $4 to $4.5 billion. Again, your staff can get the exact figures on that.

Just kind of winding up then, because I have probably gone over time here but I do want to get these kind of basic terms in here and lending background. The real necessity of the SBA is, in fact, it is the main source of long-term financing for most small companies. If you try to privatize the SBA, first of all, the banks can't do it because they are short-term lenders; insurance companies aren't going to do it because they don't like to make small loans; and I don't know of any other institution that would be interested.

Furthermore, apart from the social value of trying to enhance entrepreneurship in America, the fact is the Federal Government has economic sources of income from the SBA Program that a private lender wouldn't. You lend money; you get an interest rate plus a guaranty fee. That would be available to a private group in addition to the Government. But the Government has other sources of income that come out of the SBA Program. That is, the income taxes that come from the corporation and the income taxes that come from the officers and the employees that work for the company, and statistically you can show that the SBA guaranteed loan program makes more money for the Government than it spends.

So, with that, I'll conclude and be available for questions later thank you.

[Mr. Foley's statement may be found in the appendix.]

Chairwoman MEYERS. That was excellent, Mr. Foley. I think you gave us all an outstanding background and explained to me some things that I didn't know.

Mr. Weaver.

TESTIMONY OF HON. A. VERNON WEAVER, ASSISTANT TO THE CHAIRMAN OF THE BOARD, STEPHENS, INC., WASHINGTON, DC, FORMER SBA ADMINISTRATOR, 1977–1980

Mr. WEAVER. Thank you, Madam Chairman, members of the committee. Cut me off if I talk too long. I am going to read mine and try to stick to the time limits.

As I understand it, this hearing is being held for the purpose of determining whether or not the SBA should be continued in its present state, reorganized by eliminating or merging certain of its programs, or discontinued altogether—in the present vernacular, zeroed out. I will list the common perceptions and complaints that I have heard as administrator and in the 13 years since I left office, and I would like to address each of them.

The first problem that you hear about the SBA is, you have got to be a minority to get a loan, and that is pervasive, I hear that everywhere I go. They say, "What did you used to do?" Administrator of the SBA. "Oh, hell, I'm not a minority so I can't get a loan."

Second, SBA guaranteed lending is off-budget financing and therefore should be abolished. That is one of the Stockman tenets, and some other folks in the Congress.

Too much bureaucratic red tape, the loss ratio of SBA lending is too high, and entrepreneurs can't get loans from the SBA. Let me briefly address each of those.

The first one, as far as minority lending is concerned, it is completely untrue. During my time at the SBA we had great difficulty in meeting our goals for minority lending, and the goals were based

on population. That misconception may rise because there have been in the past certain programs that were limited to minorities. I don't think that is true any more, and certainly a great majority, probably 90 percent, of the loans that the SBA makes are not to minorities, they are to majority firms.

The complaint that says guaranteed lending is off-budget financing goes to disaster lending, ladies and gentlemen. Disaster lending is really not the SBA. Now you can argue back and forth as to whether the SBA should be in the disaster lending business. The argument always comes down to, the SBA does a good job, and they have, they have, but it is not small business lending, a lot of it is home lending. That portion of SBA's financing comes through the Federal Finance Bank, or at least it used to, and that can be called off budget, but to say SBA financing is off budget because guaranteed lending is just not proper.

Third, I am going to cover at the end of my statement because I had some experience in that after I left the agency.

Fourth, the ratio is too high. When I was administrator I heard that from time to time, that Congress has never set a standard for the SBA to come up to as far as the loss ratio is concerned. Since the SBA is the lender of last resort, one would expect the loss ratio to be considerably more than that for a commercial bank, and they are. Banks try to keep their ratios at about 1 percent. SBA losses have averaged 6 to 8 percent.

While I was administrator we figured that if we ran off the loans—that is, if we stopped making loans and just ran off the loans that we had on the books, the loss ratio would go up to at least 10 percent. If you don't like that, you have the power to set what you think the goal should be for the SBA. I don't advise you to do it, Madam Chairman.

Chairwoman MEYERS. That is an average of all programs?

Mr. WEAVER. That is the SBA guaranteed lending programs.

Now you will find, at least when I was there, that the direct lending had a very much higher ratio, and I am recommending that if there is direct lending it be abolished, but as far as the majority lending SBA does, you can figure, rule of thumb, 10 percent. Anybody that understands finance knows that you can make that 5 percent or 2 percent or 20 percent. It is a question of where you think it should be. It kind of naturally falls in that 7, 8, or 10 percent range if you make loans that the banks will not make.

The last objection that you hear from time to time is that entrepreneurs can't get loans from SBA. Of course that is ridiculous. Every loan the SBA makes is to an entrepreneur.

Every time a loan is turned down, as you well know, the applicant becomes angry and calls you or other authorities. Most of those loans are turned down because the loan officer cannot be assured that the loan will have a reasonable possibility of repayment, and that is what the law says. As a loan officer for the SBA, I can't make the loan if I don't think it is going to be paid back, and that puts a restriction on my ability to make that loan.

Most of the people who do the complaining are what we call story loans. At least they did in my day. That means, someone comes into the agency, they have got a great story: I can do this, I can make this; but they have no money, they have no collateral and

you can't make the loan. These people are candidates for venture capital, but they are not eligible for that either because they just don't have the equity or the track record, and my advice to them was, go to work for someone else in that business for a couple or 3 years, buildup your experience and your expertise; meanwhile, try to raise some equity, and then come back and see us, but what they do is call you.

In my opinion, if the committee questioned each former administrator instead of the three you have here—and maybe these three would agree with me—you would find agreement on two things. First, the agency should be continued; and, second, some programs should be merged and other others should be eliminated. I am going to make a few suggestions along those lines, for what they are worth.

For merger I suggest that advocacy and minority small business could be merged. Procurement and the 8(a) Program could be merged. Finance and investment could be merged, and perhaps they are already. Now those are things that might save a little money by merging programs within the agency. Privatization: I think most of management assistance could be privatized, and a great deal of it already is.

7(a) lending already is privatized to a great extent because the banks are making the loans. Gene Foley started the Banks Guaranty Program. I took that a little farther by establishing the Bank Certification Program and the Preferred Bank Program, under the terms of which, banks that meet certain qualifications can make the loans on their own without even consulting the agency and notify us of the guaranty.

Under elimination, I say all direct lending, and it may already be eliminated, but direct lending is a poor idea, and I won't bore you with the reasons why, but I will if you want me to.

In 1978 the Congress directed the Small Business Administration to hold a White House Conference on Small Business, and we had a meeting up in Newport, Rhode Island, of all the district directors and all the other managers of the agency. It was a Government facility, and a lot of money wasn't spent on having fun, I assure you, it was a barracks up at Newport, Rhode Island, at the Navy War College.

Anyway, at that meeting we required every person there to rate all the programs of SBA. We had about 20 programs. We rated them 1 right on down to 20. I don't know where that list is, but I'd recommend it might be a good idea at this stage of the Congress's thinking to go back and review what the people at the SBA, all the way down to district director, how they rated each of the programs that SBA has. I remember that advocacy was number one, and I have forgotten how the rest of them worked out, but those minutes should be available.

I would like to spend the rest of my time—and I may paraphrase some of this—by talking about an experience I had after I left the SBA. I was asked by a bank holding company, 10 banks, about a $2 billion company, to come over and spend 6 months and try to raise the amount of SBA loans that they made. I met with every one of the loan officers, there were about 660, and I heard the same stories that I have just given you—too much red tape, we are not

going to put up with it, it is just too complicated, takes forever, not going to do it.

Well, the first thing I did, with the bank's approval, the bank officers' approval, was to go through the loan files of that bank, and, believe me, it was a revelation to me. I had never actually worked in a bank as I am an investment banker. We deal perhaps with larger situations, so we are perhaps more careful than the average bank, but these were 10—some of them were country banks, and you wouldn't believe the state of the files of these banks. Some of them didn't have a note; some of them didn't have current financial statements. These are things you have got to have, folks. I mean if the time to foreclose comes, the first thing the judge says is, "Let's have the note." Well, if you haven't got a note, you are not going to foreclose on that loan.

So, I was able to convince the officers of the bank that the files that they had on each of their loans really wasn't what they perhaps thought it was, and we concluded, after going through the SBA checklist, there wasn't a single thing that the SBA required that a prudent banker should not also require.

I would like to repeat that. There is nothing the SBA requires in the way of paperwork that a prudent banker should not require and have in their files.

The problem of taking too long. These folks actually were a certified bank, the main bank was, but they hadn't been using their authority. So, we trooped over to the SBA office with the head loan officer, and we agreed that we would put the preferred bank rules in effect, and that is to say, the bank could make their own loans and let the SBA know about it. Oddly enough, the bank officials didn't want to do that. They said, "We like the SBA approving these loans." I guess it gave them a little better feeling of security. So, the SBA office agreed to turn the loans around three business days after they got them, providing they, of course, were in proper shape, which they were.

Then we addressed the secondary market. Most of these bank officers had never heard of the secondary market, and maybe some of you haven't, or at least don't know very much about it. The secondary market is really the third stage: Put the guaranty on, let the bank make the guaranteed loans, and then the guaranteed portion can be sold in the secondary market, and this gets to the reason that a bank can make a longer-term loan with a guaranty than it can without a guaranty. You can package up that guaranty, whether it be 90 percent or 80 percent or 75 percent or 50 percent, and you can sell it in the secondary market.

The SBA has established a fiscal and transfer agent in New York, which was done during my time, and you can sell that part of the loan for a premium, you can make money on it. I can go through that procedure if you want me to, Madam Chairman. It takes a while, and I won't take up your time, but if you want to know, I'll tell you.

Anyway, when you sell a loan, on the average you make 2, 3, maybe 5 percent premium on that loan because of the fact it has a Government guaranty on it. The loan to begin with didn't have a Government guaranty.

Long story short: The bank in the approximately 6 months I was there made something over 100 loans totaling almost $50 million with a premium of over $1 million. That means the bank made a profit right up front on those loans of $1 million, and it got the money back, 90 percent or 80 percent back, to loan out to some other small business.

So, I know that program works because I have done it, and there is no reason why it can't work again. Any bank that wants to put it into effect, albeit it has to have proper supervision, it is there. When I was at SBA I would say there were, oh, out of the thousands and thousands of banks in the country then—there are a lot less now—there probably were 200 banks that made most of our loans and maybe 100 made half the loans. It is just ridiculous that some bankers really get the program and make a lot of loans; most banks don't make any.

I have spent my time rebutting false perceptions about the SBA because I think that is what you members will be getting from people as you investigate further whether or not you should keep the SBA in force. Administrator Foley was more positive, and I am sure that the other two gentlemen that will follow me will be also more positive, and I thank you very much, Madam Chairman.

[Mr. Weaver's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much, Mr. Weaver.

Mr. Sanders.

TESTIMONY OF HON. JAMES SANDERS, FORMER SBA ADMINISTRATOR, 1982–1986

Mr. SANDERS. Madam Chairman, members of the committee, Mr. Lynch, I appreciate the opportunity to come here and talk. It is kind of fun, and I'm sure that Gene Foley and Vernon Weaver agree with me, it is much easier to be here as an ex-administrator and not have to defend everything the administration puts you up to, and you can talk freely and frankly about your experience.

I knew that my two colleagues my on my right here would do a wonderful job going into the 8(a) Program and the loan program, and so I—as you will see the statement that I have filed here, and, Madam Chairman, if it is all right with you, I'll file it for the record, where it will probably repose in some file for the next 70 years and never be looked at again.

Mr. HEFLEY. You have been here before.

Mr. SANDERS. Yes.

My comments in that statement of mine were to go to the bottom line of the SBA, to take it into its component parts and examine it, and I agree so much about what Vernon said about, the perception of the SBA is quite different than the reality.

You hear all the horror stories that arise out of these years and years of involvement in programs that were wonderful ideas at the time they were conceived, and they were put into programs, many of which were supposed to be temporary, and they continued to be institutions for years thereafter.

Many of these programs were pretty high-risk programs, and they created some scandals, and they were defrauded, the Government was defrauded, and we hear about those things, and, incidentally, in passing, I might comment that in most of these programs

the SBA never was funded with an adequate amount of money or the mechanism to really regulate and administer the potential fraud involved in all those programs

But going to the bottom line, if you will look at my statement some time when you do get it out of the file, you will see that what I have tried to do is point out that when they say, "Well, SBA, I know it is a $10 or $20 billion agency, loans of all kinds of money," others say, "No, it is not a $10 billion, it is about a $40 billion agency. Didn't you know that they have got contracts in there, they give out contracts for $40 billion." Well, they don't give out contracts for $40 billion. Of course that is the level of the small business set-aside program that is competitive for Federal procurement, and that costs about $20 million to run that program. The lending program, which is the largest outflow, is also a creator of new sources of lending.

Back in the 80's when it was being criticized by some economists as not being any additional credit that was created, but simply apportioning what was the existing credit to less worthy borrowers, that criticism was far off the mark. It does create more liquid funds through the guarantees because the banks can sell those guarantees and regenerate their funds to make more loans. That is a function that only the Government can do. Who else would stand behind and give a guaranty?

The real question is, is it profitable? Is it worth it? Is the outflow and the loss ratio worth the amount of economic activity that is created? So those are the points that I was trying to make when I took the component parts of the agency and looked at them, the various programs.

Now there are two programs that I have pointed out could be considered to be done in different ways. First of all is the Disaster Program. Disaster lending has been done very well by the SBA. As a matter of fact, I suspect it is why they continue to look to the SBA to do the disaster lending rather than some other agencies, but nonetheless it is an enormous strain on the administration, on the facilities to hire all the temporary people who are qualified to go into an area that is ravaged by an earthquake or flood and make these loans.

I think the real question I have—and, incidently, while we are on that subject, that program was expanded from time to time by various people in Congress that wanted to expand it to nonphysical disasters. I can remember we had, would you believe, a peso devaluation program during the 80's which was to assist people, American businessmen who had been hurt by the peso devaluation and the purchasing power in the Rio Grande Valley.

When I stepped in, I found out we had a big portfolio of loans that had been made previously to farmers in the southeast from a drought, and of course that created some awful problems when they discovered some of the lending funds were spent on yachts in Florida. These kinds of things constantly gave the agency a bad name. The agency didn't think these up, various congressional delegations thought these up, or single Congressmen or Senators. It was a wonderful idea for them to get the attention of their voters.

I remember, they wanted me also to get involved in the fishing disaster up in the Northwest because of El Nino and to refund all

their boats. We drew the line on that one. But that was the problem. The Federal Government has never made a decision or a strategic plan about what they want to do about disasters. There is a mix of insurance, flood insurance, which isn't adequate. There is the problem of insurance companies withdrawing from the earthquake areas. It is a business I know a lot about the insurance industry. There is the loan program; there is the grant program. When any disaster happens, you have about four officers of Federal agencies and State agencies coming there. The people are totally confused about what they can do and what is available.

I think the Government has to decide how they want to do this. I don't think it belongs in the SBA, although they have done a wonderful job in administering it. I think you ought to really decide what FEMA is all about and make an optimum plan for national emergencies.

I pointed out what the 8(a) Program needs—it is one of the biggest sources of scandal we have. It is a constant problem of trying to find out who is fronting, who is not really a minority but pretends to be a minority with nonminority people behind them. Certainly a few firms have done very well, and when I was there we instituted the first real graduation from the program because many of the firms had done so well that they had become millionaires. They were no longer small, they were big, and they were taking most of the funds out of the program. About 35 firms were taking almost 50 percent out of the program at that time, leaving the other 1,900 firms with almost no attention at all. So, it hasn't worked as it should have, in my opinion.

A need is still there to give minorities a leg up, and particularly for blacks and Hispanics I think that the need is the greatest. You have to decide how to give those people who haven't been helped, particularly in the inner cities, some opportunity and train them so they can get on the entrepreneurial track. But the way the program works now is not effective. You should get some successful business people from the minority area to sit down and help you figure out how to make it work.

Direct lending was something that we virtually ended in my administration, and it was—and I totally agree with Vernon, it was a real loser. Glad we got rid of it! I think that one thing you should all keep in mind as you are going through this—Congressman Hefley I think referred to it—it is going to be a tough, tough row that you have taken on here to try and cut back these Federal programs to cover the deficits. That is certainly the single most important thing to all businesses—that we get this deficit under control. But it means that Congressmen can't use the SBA any longer as a convenient dumping ground for their private trophy to take home to their local constituencies. I was pleased to see that in the new 1996 budget the administration agreed to strip out $27 million worth of nice little gifts around the various districts. That kind of thing is what also creates embarrassment for this agency. That is how it got its bad reputation. That is part of it, at least.

Finally, I would like to say something about the self-employed section of small business. That is a huge section, and not many people talk about it. In the United States only 30 percent of small businesses, about 6 million of them, are full-time businesses with

employees; 45 percent of all the small businesses, about 9 million of them, are full time with no employees, in other words, self-employed people; and about 25 percent are part-time self-employed with no employees.

Now that is about 14 or 15 million small businesses with no employees, but they are gainfully working, they are not on welfare. Some will never be the gazelles that will leap into the future and create vital new businesses or growth patterns, but they are independent, they pay taxes, and in my opinion they have been virtually ignored. They also were the source of the greatest growth. They were the reason people who got laid off in larger businesses found something new to do.

The net growth between 1989 and 1991 was over 2½ million new jobs in the firms of zero to four employees, and from 5 employees up to 100 employees there was a net loss of 2 million jobs, and then on the other end of that scale, above 500, there was a gain of 120,000 jobs. So, you see, most all of the new jobs created in that period of time were in the very small firms of zero to four employees, and yet those people, I think, have been largely ignored for the contributions they make and the fact they are not dependent on some other kind of welfare program.

Their home office deductions have been reduced by the IRS, the home office workshop where they make things. The new regulations are such that most cannot take these deductions on their taxes. The independent contractor rules have been changed. Incidentally, I'm pleased to see there is a House Resolution 582 that has been introduced by Representative Jay Kim to clarify that. They have virtually been eliminated from deducting their travel and entertainment and meals by the IRS regulations, and another House Resolution, 408, has been produced for that one. I like to draw your attention to those things because this is a vital part of the economy.

The Regulatory Flexibility Act needs some attention through judicial review, and I know that that is part of the Contract With America, and I think it is a good thing to look at.

Finally, I would like to say in closing, Madam Chairman, that I have had a wonderful experience at the SBA, and I want to pay tribute to the civil servants that work so hard there. Most of them are hard-working, dedicated people, and public service they believe is an honorable thing to do. Of course, there are always a few bad apples in every barrel that take away from the credit these people deserve. Finally, I would like to say that, in closing, still the most important thing for all businesses is the elimination of the deficit.

Thank you.

[Mr. Sanders' statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much, Mr. Sanders.

Mr. Weaver, I wonder if I could call on you to give a brief introduction of Mr. Barry Baldwin since I believe you have worked with him in the past.

Mr. WEAVER. I have. It is a pleasure to introduce him.

Let me second what Administrator Sanders said about the employees of SBA. I also found some very fine people there. They compare well with the people at Stephens, Incorporated, where I work in the investment banking field. They are not a bunch of duds, they

are hard-working, decent, honest people for the most part. A few sour apples always give the rest of them a bad name, and it is too bad.

It is a great pleasure to introduce Barry Baldwin to you. Barry is from London, England, lives in Windsor, England, near the Queen. I have known Barry for about 15 years, and he is, along with two other folks, Mr. Small Business of the United Kingdom.

His colleague, Sir Michael Grylls, a conservative member of Parliament, would be the chairman of the small business committee if they had a small business committee, which they do not. But it is a great pleasure to introduce Barry. He knows all about what is going on not only in Great Britain but also all of Europe.

Chairwoman MEYERS. Thank you, Mr. Weaver.

Mr. Baldwin.

TESTIMONY OF HON. BARRY BALDWIN, HEAD OF RESEARCH, SMALL FIRMS IN THE U.K., SMALL BUSINESS BUREAU, LONDON, ENGLAND

Mr. BALDWIN. Madam Chairman, members of the committee, I am delighted and honored to have the opportunity to address you today.

Back in the late 70's the U.K. smaller firms sector had been in long-term decline for some 50 years. The decline in the sector had been matched by increased economic concentration in the U.K., which was a major obstacle to the creation of an economic climate in which smaller, independent firms could survive, thrive, and prosper. For too long in the U.K. the interests of smaller firms were largely ignored in the belief that the promotion and development of major companies was for the benefit of industry as a whole and the economy and the country in general.

It should be appreciated that in the U.K. we did not have any comprehensive legislation on smaller businesses. There was no clear policy framework for these firms, and therefore there was a smaller commitment of resources and a less elaborate range of measures than in any other comparable country. The U.K. had no effective body within Government to defend and represent smaller firms. No part of the U.K. Government machine looked at the impact of regulations on smaller firms, and no one was concerned about fair competition between all the varying sizes of business enterprises, and no one knew, for example, the extent of Government purchasing from smaller firms.

Smaller firms in the U.K. were not seen as a significant contributor to creation of national wealth nor as a significant contributor to employment generation, and nor were they able to take a lead in solving the problems of innovation. Their role in helping to underpin a free society and create greater social balance was not recognized and was not understood. The concept of ownership as a vital motor of wealth creation, particularly in local communities, with a commitment to remain in those communities, this also was not recognized. Therefore there was no encouragement to individuals to start their own businesses, and, importantly, there was no encouragement to existing business owners to put their achieved success at risk and to seek to grow their companies.

A number of us in the U.K. concerned about the state of our small firms sector in the late 70's visited the United States on a number of occasions at that time and also in the early 80's. We were searching for ideas and understanding. We wanted to know why the United States had such a successful small business sector generating wealth in local communities and creating new jobs.

What we found was that small business was seen as the foundation of national security and free competition which was considered vital to the American free enterprise system. There was antitrust legislation, unheard of in the U.K., which underpinned a merger policy, with the strategic function of preserving competitive markets by preventing forms of concentration where the effect would be substantially to lessen competition. It was clear that the U.S. courts at that time also sought to preserve opportunities for small businesses to enter the market and also sought to protect the consumer from exploitation.

This was a fundamentally different concept to British merger policy which took a relatively uncritical view of the development of takeovers and mergers, seeing it as a useful way to help industry restructure and help the recovery of the British economy. In the U.K. the impact of such concentration on smaller firms was ignored for the so-called greater good.

Second, we found you had a specific Small Business Act under which the Federal Government had a legal obligation to aid, counsel, assist, and protect small businesses. In the U.K. there was no such Government understanding and support, and it was little wonder that the U.S. small business sector was so much more dynamic and comprehensive than our own.

We recognized the role of the Small Business Administration and the commitment of its people to the success of the sector. Not least, we were impressed that the administrator was appointed by the President and had direct access to him. In particular, we were also impressed by the advocacy role for small businesses provided by the SBA, an effective body within Government to defend and represent the interests of the sector.

We became certain that our task in the U.K. was to convince Government and big business of the need to implement a smaller firms policy which discriminated positively in favor of such firms. The absence of such a policy would mean inevitably effective discrimination by default against smaller firms. Such a conviction was little short of heresy to the British tradition of effectively doing nothing in the name of free competition and the concept that big is beautiful.

Fortunately for us, the British political and business environment was undergoing fundamental change following the 1979 general election. Despite a very conservative Conservative Party in power and a very conservative civil service bureaucracy, we were led by a rather radical prime minister with a small number of radical colleagues, particularly in her policy unit. Without initially recognizing its full implications at the time, we had entered an era of conviction politics which questioned the traditional British system and repeatedly asked "Why not?" when new ideas were formulated.

Prime Minister Thatcher, to her great credit, recognized that success of an enterprise culture required not simply encouragement by

Government but also direction, the hand on the tiller, and the fundamental change of attitudes. There had been something almost unclean about a person successfully running his own business and making, of all things, a fair amount of money. Successful independent business people tended not to talk about that success. Thankfully, Margaret Thatcher gave us the impetus to break out from that outmoded culture. People were encouraged to seek a life of achievement and not settle for a way of life. She challenged individuals to become contributors and creators and not simply takers from society, and slowly it became respectable to own your own business and to be successful.

A positive imagine was created of business owners, encouraging an increasing number of people to take the risk of setting up their own business, and not least were the disenchanted middle ranking executives from major companies, supported by venture capitalists, who spawned a substantial number of management buy-outs and management buy-ins that occurred in the U.K. in the mid to late 80's.

The results of this culture change in the U.K. are plain to see today despite the impact of the recent recession. In 1979 we had nearly 1.8 million smaller firms. Ten years later the figure was almost 2.9 million. Currently we are a little below that figure, but with the recession over our new firm startups are back to over 400,000 a year. Self-employment is up from 1.9 million in 1979 to around 3 million at the present time. Economically the U.K. is in good shape, and for the first time in our history we have emerged from recession with an export-led recovery with low inflation and annual growth forecast at over 3 percent.

It would be easy for our Government to be convinced they had done it all and revert back to the bad old days when discrimination in favor of smaller firms was regarded as an unacceptable intrusion in the market. But we need an increasing number of smaller firms, not least to replace those that do not emerge from the startup and early survival stages of business. In particular, we need to encourage those with the ability and opportunity to grow to do so. They are a vital but very small minority of the pack which must be encouraged to put their existing success at risk and grow their businesses. Government needs to understand what the barriers are to such growth and which of the barriers Government can influence and erode.

The British Government is now convinced that what lies at the heart of understanding the problems and needs of the sector is a real and active partnership and dialogue between business, Government representative organizations, and the financial sector. The success of the economy as a whole and the smaller firms sector in particular depend on creating the climate and culture in which enterprise can flourish and is rewarded. Because of their value to the economy, the U.K. Government now believes some continuing adjustment to market forces is necessary to ensure that smaller firms are not unduly disadvantaged by their size.

The U.K. Government smaller firm policy focuses on three main areas today: Creating a favorable economic climate, reducing bureaucratic burdens on business, and providing direct assistance to smaller firms in three areas: First, access to finance; second, train-

ing and manager skills; and, third, business information and advice. I do not believe it is mere coincidence that the SBA has traditionally focused on these policy areas, finance, advocacy, and management assistance.

The U.K. Government remains committed to smaller firms. It is confident they will form a dynamic and growing part of the U.K. economy throughout the 1990's and into the 21st century. We have learned our lesson from the decades of neglect. That lesson is a potent reminder to all Governments of advanced industrialized countries to ensure they embrace a consistent policy to aid, counsel, assist, and protect their small businesses. Without positive discrimination in their favor, it is now clear that smaller firms will not be able to cope with the imperfections of the marketplace and make their full contribution to wealth creation, job generation, and innovation linked to the economic and social balance which they underpin.

I thank you for allowing me to make this presentation to you.

[Mr. Baldwin's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you so much, Mr. Baldwin.

It is my practice to withhold my questions until later and start with members of the committee, and our first questioner will be Mr. Hefley.

Mr. HEFLEY. Thank you, Madam Chairman, and thank you. This is a very enlightening testimony. We appreciate all of you coming, particularly appreciate you, Mr. Baldwin, for coming so far to share with us.

It sounds like in Great Britain you have somewhat the same kind of problem that we do in this country, and I would like for you to tell me if I am correct in this or not. In this country it seems like we in Government do everything we can to destroy the entrepreneurial spirit with taxation, regulation, court proceedings through liability law, and then we have a Small Business Administration that is supposed to help encourage that entrepreneurship, and so it is a kind of schizophrenia. There would be those that would argue that in Great Britain it was the same way—that you almost destroyed your small business sector, and then the Government stepped in and is trying to encourage it. Is that true? Are you convinced that they are encouraging it with some degree of success?

Mr. BALDWIN. Yes, it is certainly true. The problem, I think, is that Government bureaucracy and big business are natural bedfellows, they talk the same language, they get on extremely well together, they communicate well together, and one of the interesting things—because we of course found out about your set-aside program many years ago—is that Government spending, which is a significant part, I think, of most countries' GDP these days, Government spending actually has an adverse effect on small business.

You will find in all countries, and I believe probably in this one, certainly all the European ones, that big business has a greater percentage of Government contracting than is their share of GDP, because it illustrates what you are suggesting and I agree is the fundamental problem, that big business can talk to Government far more easily and effectively than small business, and by doing so we effectively discriminate against small business, which is why we

need these initiatives, why we need this Government intervention, simply to balance out the marketplace, and I think without the intervention you effectively discriminate against small business. Whether you intend to or not, it happens, and that I think set the fundamental problem that we had for 50 years or more.

Mr. HEFLEY. Thank you.

To the rest of you, one of the frustrations I have had in my 8 years on this committee is that we have spent most of our committee time arguing about set-asides and carve-outs for certain segments of small business. Would it be better if we stopped all of that and we stopped caring whether the small business was red or yellow, black, or white, and we just were concerned about it being small business? Would it be better just to look at the size of the business?

I have used the illustration in here before, and I won't belabor it, that I had a black gentleman from North Carolina come to me and was considering buying to land to start a business in my district in Colorado, and he qualified for one of these set-aside programs, but he was a multimillionaire, very successful businessman, but because of the color of his skin he qualified for one of these programs, and it made me think is this what we are really trying to do? Do we care what color his skin is, or do we care whether he is a small businessman that we have a program to help?

Would you respond to that, any of you?

Mr. WEAVER. The committee thrashed that problem around at length back in, I think, 1978 and came up with a definition, rather than minority of disadvantaged, and in order to be disadvantaged you had to be not only—economically disadvantage was a factor I guess is what I am getting to. I don't know if that is still true or not, but certainly social disadvantage is one thing and economic disadvantage is another.

Now we spent many, many hours trying to figure out what economically disadvantaged was: Does half a million dollars and above make you not disadvantaged? We don't know. We finally had to put the problem on the individual officers out in the field to say, if a person is not socially and economically disadvantaged they are not eligible.

Mr. HEFLEY. By definition—and I wish I could remember the exact program he was coming under, but by definition the fact that he was black made him socially disadvantaged.

Mr. WEAVER. It might have been 8(a).

Mr. HEFLEY. At least according to his program—it may have been the 8(a) Program.

Another question I would have, and then I will end so that others can—most of what you talked about is the Small Business Administration loan programs, and that is the heart and the most important, I think, or the guarantees and that kind of thing. But are there other ways that we could do this, provide the guarantees for loans without having a whole department with all of the expense and the bureaucracy and so forth to do that? Could this be sized down, spun off into, I don't know, the Department of Commerce or just be a small segment of something, or could we do it some other way other than have a Small Business Administration?

Mr. WEAVER. Let me answer that, and I am going to quit dominating too. I'm sorry.

After I left the agency I was back in the investment banking business, and a chap named Jim Ramsay, who is now deceased, was given the task of going into the business of whether or not the SBA could just be privatized altogether, and particularly the 7(a) loan program which is the bulk of the agency, and we met at length on this subject. We had a fellow from Merrill Lynch on the committee, we had a fellow from Amback, which is a municipal bonds guaranty fund, Goldman Sachs was there, so we gave it a pretty good run.

At the end of the time, the idea was, how could we phase it out and do the SBA without a Government guaranty, and I guess the answer was, you couldn't. Now you can do everything but, but the Government guaranty makes it run. It gets the secondary market into the picture. That full faith and credit is just something that has got to be there if it is going to work. At least that was what we decided. Really, Merrill Lynch and we and Goldman Sachs were looking at it: Is this something we can make money at doing? The answer was no. The use of the banks, through the certified programs and letting the bank's employees do the work and delegating them the authority to actually make the loans, even going—maybe there are ways to go farther than it has gone—that is the way to privatize, but I don't think you can do it without the Government guaranty, at least in the loan program.

Mr. HEFLEY. Is there a way to do the Government guaranty though without having an agency?

Mr. WEAVER. Well, yes, but you almost have to have an agency, at least a nucleus of one, to administer the guaranty so it is not abused.

Chairwoman MEYERS. Are you saying, Mr. Weaver, you are going to have to have the people to administer it, whether you put them in a corner of the Commerce building or whether you leave them in the place that they currently are?

Mr. WEAVER. A corner of the Commerce building is bad language to all small businesses because of the obvious big business conflict. So "somewhere" might be a better word, but not the Commerce Department.

Chairwoman MEYERS. Excuse me.

Mr. SANDERS. If you are talking about a blanket guaranty like the savings and loans companies had at the SLIC or the banks have, I think that you really would court problems because it was just that kind of approach that was a blanket coverage for depositors that was an easy out, and if your guarantees were just blanket without underwriting them, without some authority to say this is acceptable or not, you would get in trouble.

In my remarks here I am a little more conservative than my two friends here on my right, and perhaps I have been a little too cautious, because I strongly favor guarantees that are less than 90 percent, and when I was administrator we expanded the Preferred Lender Program to have the pen and authority if they took a 75 percent guaranty. I wanted that bank to be a partner with us and the taxpayer, because at 90 percent many of them come out even or ahead when they sell off the guaranty at 110 percent, and then

they service the loan. I am not against that, I want the banks to make money on the small business loans. That is very important because, as Mr. Foley pointed out so well, banks don't want to make small loans, it is just as much trouble to wrap up a portfolio for a $2,000,000 loan as it is for a $50,000 loan, and you make a lot more money on the $2,000,000.

So, that is what you are struggling with at all times. If you set an acceptable loss ratio for the lending program, I am sure that the agency can run it on target. Then the return, if you measure all the taxes and the businesses that prosper and pay income taxes, will exceed the loss.

Mr. HEFLEY. Madam Chairman, I lied about being through. Let me ask one other question, and I think Mr. Foley had a response to that question.

Mr. FOLEY. Mr. Hefley, I just wanted to comment. First of all, there is no private institution that would have the credit ability that the U.S. Government has in terms of a guaranty. If you permitted the banks to issue a U.S. Government—first of all, I don't think you can do that without any type of auditing function. If you just let the bank say, "Well, listen, we will put an 80 percent Government guaranty on here and we won't have any SBA supervising authority," that would lead to tremendous abuse.

I want to make a comment on the minority program. I don't claim to be an expert on the 8(a) Program. I am somewhat knowledgeable, not as knowledgeable as I think I am on the 7(a) lending program. But just to give you a little history, in 1963 I became Administrator, and shortly after I became Administrator I started inquiring as to how many loans we were making to what were then called Negroes, and nobody really knew. There weren't any statistics, there was no evidence. So, I finally concentrated on Philadelphia, and I subsequently wrote a lengthy article in a scholarly journal called Daedalus

We found in Philadelphia, just from going back by memory, from those who had been in the agency since 1953 to 1963, during that 10-year period, seven loans had been made to Negroes in a city that even at that time was almost a third black. I created a new program. I am saying this for a purpose, because it gets on to the 8(a) Program. I started a program of just $6,000 for 6 years, no collateral, no equity investment. What I did require is a 6-weeks program 1 night a week for 2 hours, that there be a management training program. If somebody called in sick, their grandmother had died, or the baseball season had started, they were automatically eliminated.

Let me tell you, that first year we made 98 loans. Not one of them ever defaulted. I mention that because it showed the tremendous potential of the black community in the business area that, for larger social and cultural reasons, had been discriminated against, but they had a potential if given the opportunity. Later, we got a law passed that permitted us to do that up to $25,000, the equal opportunity loan program. I am afraid to say that some years later the management training program hurdles were taken away.

By the way, my philosophy on this is, it isn't efficiency that makes a small business survive. Efficiency makes a small business

person highly successful or highly competitive, maybe rich, but what makes him or her survive is tenacity. That is what you have to do, is put hurdles to make sure that those qualities of tenacity are exhibited.

Getting on to the 8(a) Program. We are now 30 years down the pike from when we first started the Minority Lending Program. My belief is that minority contractors do have a big hurdle to overcome without the assistance of the Small Business Administration. How long that is going to continue I don't know. It is part of the society at large, but if you are going to ask me, and just so that it is on the record, it is my judgment that there has to be some continuing assistance for at least another 10 years.

Mr. HEFLEY. Thank you.

For each of the former administrators, if you would respond to the situation I mentioned about the administrator coming down and doing the health care, pushing the health care thing, clearly not something that helps small business, how did you handle your role as working for the boss down there in the Oval Office on the one hand and, on the other hand, working for small business, being an advocate of small business? How did you handle your advocacy role?

Chairwoman MEYERS. Mr. Hefley, after we have one answer here I am going to have to go on because we have so many people who wish to ask questions.

Go ahead.

Mr. WEAVER. The answer is that it is not easy, and the answer is that you do what the White House tells you to do unless the chairman says, now, after belaboring it for a while, usually, "What do you think personally?" and under those circumstances, at least in my experience, we were permitted to give a personal opinion.

I don't know about the rest of you.

Mr. SANDERS. Yes. I had probably a more unique experience in that area because the agency was, to my surprise, suddenly put up for elimination while I was still the administrator. I wasn't told when the director of OMB made the announcement. He made it affecting other agencies too without consulting them.

I went to the budget appeal because I said there are better ways to do what we are doing and we can get some support from Congress but this proposal will never work. We had carved back, almost eliminated, the direct lending program. We had started the graduation program in the 8(a) Program to let more smaller minority people in it. We had done these kinds of things, started the women's conferences around the country for women business owners, but that wasn't enough with the director. Then we came to a division. I sent a letter out, supporting the President's Program, to all employees to hold fast. But the director wanted me to come to the hearings and use figures that he had cooked up and even in his own book he confesses that he created the figures out of the air. I would not do that.

So, he had to come and present his own figures, and he sat at the table instead of me. That was the only way I could both be responsible to what I thought was the truth and continue to manage the day-to-day affairs of SBA. I stayed aboard after the Director

left OMB for another year and a half just to make sense out of what was going on.

It is not easy, as Vernon says.

Mr. FOLEY. My thought on it is that an administrator of the Small Business Administration or the Secretary of Agriculture, or the Secretary of Labor, lives in a political world here in Washington. While you may be a spokesperson for small business, in the case of the Administrator, you also work for the President. I agree with Mr. Weaver here. I don't think it was unseemly of the Administrator or, as a matter of fact, the President to ask the Administrator to comment on what is the effect of this health care bill on small business; or asking the Secretary of Agriculture what is the effect of this health care bill on farmers, or the Labor Secretary on labor.

So, it is just a fact of life, Mr. Hefley. You wouldn't want to have it be your sole function, to be a lobbyist for matters unrelated to small business. You may disagree or agree with the health reform bill, but I don't see anything untimely or unseemly about commenting as to its effect on small business.

Chairwoman MEYERS. Thank you.

Mr. Thompson.

Mr. THOMPSON. Thank you, Madam Chairman, and let me compliment you on this panel. It has indeed provoked some of us to thinking very seriously about some of the programs.

Nonetheless, I am troubled that the perception is that programs that have been designed to encourage participation by certain racial or ethnic groups have failed. I am troubled by the examples that people tend to give without specificity. That troubles me because, as one of the black members of this panel, every time the reference to 8(a) has been mentioned people start looking down on this end of the committee room, so that bothers me.

But even more so than that, the fact that—I guess it goes to Mr. Sanders's comments and his ultimate written testimony. I did read it, so I won't have to refer to it, but you propose eliminating the 8(a) Program in the testimony, but you didn't say it when you talked to the committee today. Please tell me what would you propose as an alternate to increasing minority participation in the lending program if you did not have an 8(a) component as presently constituted.

Mr. SANDERS. Well, I think I did mention that this had been one of my two recommendations in my oral, comments but you said the 8(a) lending, and you mean the 8(a) contracting program.

Mr. THOMPSON. Yes.

Mr. SANDERS. I put that in there. It is a provocative recommendation, not because I don't think there is a need to continue to be careful and custodial and be concerned about the lack of participation in the mainstream of black and—particularly black and Hispanic businesses, but the 8(a) Program has grown in a direction I don't think it was originally designed to do. We now say that if you are economically and socially disadvantaged, that is what qualifies but also, the last I read, it said and these particular racial and ethnic groups will be considered preferential in considering whether they are economically disadvantaged or socially disadvantaged, and then they list black, Asian, Hispanic, Aleuts, Pacific Is-

landers, Indians from Asia, and they go on; and now, I understand women! I don't know this, but when I was there we didn't consider women as a minority.

Chairwoman MEYERS. That is correct, and we still do not, and I think there have been very, very few women participants in the entire history of the program, and those had to go to court to get there because of that further description in the law that says all you have to be is socially and economically disadvantaged, but if you are a minority, you are presumed to be socially disadvantaged, and otherwise you are not. So, it is a very difficult row.

Mr. SANDERS. Well, as you know, we focused a lot of attention on women ownership in the conferences we had, and that is the fastest growing part of small business; black or white, women are growing in ownership.

Coming back to your question, Congressman, I am suggesting that there has got to be a better way than the way the 8(a) Program works now because it has been abused. As I said earlier, the program was dominated when I came in by some very successful 8(a) contractors, principally black and Hispanic. They were no longer economically disadvantaged. They didn't want to leave the program. The program was supposed to give them the opportunity to have a preferential treatment during that time, and at that time contracts were negotiated and not competitive.

But there were 2,000 firms that had been in the program, and only a few of them were getting all the action, so we asked for graduation with those firms that had already become successful and were large. I thought that was an abuse of the system. I think that that kind of thing has continued, plus the fronting and the misrepresentation involved.

Mr. THOMPSON. Well—and I don't mean to be argumentative, but I mean we have the graduation now so that is done, but your testimony gives reference as to the here and now, and what I am trying to come with is, you propose eliminating based on something that happened, based on what you just said, 12 or 13 years ago. Now if you have some current data or information that would support the elimination of this program I would appreciate it.

Chairwoman MEYERS. If the gentleman would yield, if I can just make a comment, I think last year we passed a procurement program, and in the past we have had a 5 percent goal that was Government-wide, but only in the Department of Defense could it be met by set-asides and bid preferences. Last year we said that the 5 percent goal Government-wide could be met by set-asides and bid preferences, and so essentially what we have is a program similar to 8(a) in every department of the Government, and I think it has essentially made 8(a) unnecessary because if a department within their own department can meet the goal by set-asides and bid preferences, why should they select a program and send it over to SBA for SBA to be the contractor?

Mr. THOMPSON. That is fine, Madam Chairman, but, we have an expert here who has taken and made certain references, and I am trying to get his perspective. I understand where you are coming from, but nonetheless the recommendation is made, and I am looking for the supporting references for my own benefit, and if it is

based on 12 or 13 years ago from your experience, then I think that should be part of the record.

Mr. SANDERS. Congressman, I am content; I understand what you are saying. My recommendations come out of my opinions, and they relate to my experiences of almost 10 years ago. So, there may be things that have transpired since that time to change the program in ways I am not aware of. As a matter of fact, from this statement of Chairwoman Meyers, I understand that it has been changed, and it is possibly a great improvement.

Are you happy with the program the way it is being run now? Is it helping the young beginning black business person or Hispanic person?

Mr. THOMPSON. Well, let me say that in the absence of anything else I am tickled to death over it. If I had to say that we do away with it, with nothing, and the fact that we have an abysmal minority participation record in this country in general, we have to make affirmative steps to include minorities, and this is the program.

I would like to see more. I am sure that the chairman and some other Members have other positions, but if you have been there, sir, you will know what I am talking about, and you have been the administrator. Many of the hurdles that minorities have to climb in this country are still there, and we think that there is a place for programs like this, just as Mr. Foley indicated there earlier in his comment we have to accept that burden.

Apart from that, Madam Chairman, I appreciate your allowing me the opportunity to ask questions.

Chairwoman MEYERS. Well, I didn't mean to answer for the gentleman, but I thought maybe the situation required some updating, and I also would like to say that on Monday, March 6, we are going to have a review of the 8(a) Minority Small Business Program, and so I hope everybody will participate that day.

Mr. THOMPSON. If I might, Madam Chairman, I hope, just for the record, that we do understand that millionaires can't participate in the 8(a) Program.

Chairwoman MEYERS. Now I am not sure what the limit is. Now I do think it is $750,000 now, and I think your business and home are outside of that.

Mr. SANDERS. That is the net worth?

Chairwoman MEYERS. I am not precisely sure how it is calculated, but I understand that it is $750,000 and your business and home are outside of that amount of money.

So, in terms of total assets I think you could be, Mr. Thompson.

Mr. THOMPSON. You could be, but as the law is presently constituted a millionaire could not be on the program.

Mr. SANDERS. Now by a millionaire, do you mean net worth or net income?

Mr. THOMPSON. Millionaire.

Mr. SANDERS. Millionaire sometimes means you make $1 million a year, but your net worth could be——

Mr. THOMPSON. Well, you know the perception is that it is net worth, sir, and I am just interested in making sure that the language that goes forth from this committee is correct as far as participation in the program.

Mr. SANDERS. I am glad to learn this because these are things that happened since I left. We didn't have that definition at that time.

Mr. THOMPSON. Thank you.

Mr. SANDERS. Thank you.

Chairwoman MEYERS. Mr. Salmon.

Mr. SALMON. Thank you.

I wanted to talk a little bit about the office for advocacy. Earlier, I think, Mr. Foley, you were the one that said that our Government kind of has a schizophrenic tendency to, on one side, have a group like the advocacy group to stand up for business, on the other side we are passing laws that harm business: Increased regulation, higher taxes, more paperwork, more red tape, and what I am wondering is, how can that Office of Advocacy be strengthened? How can we give it more teeth?

Mr. FOLEY. First of all, I was not the person who said that. I don't really believe that.

Mr. SALMON. I'm sorry.

Mr. FOLEY. But anyhow, the Office of Advocacy did not exist when I was administrator. I think Mr. Weaver would be better qualified to respond to that, if you don't mind.

Mr. SALMON. That would be fine. Thank you.

Mr. Weaver.

Mr. WEAVER. I would be glad to.

There's quite a bit of teeth in the law. Now it may have changed since I was administrator, but at the time I was administrator the law was brand new and there never had been an advocate appointed. The White House hates the law, or hated it at that time, because it implies a conflict of interest between the administrator and the advocate.

The law provided then, and I presume still does, that the advocate, under certain circumstances, comes directly to Congress and not through the administrator. Now that is a matter of working it out between you back at the agency, but the White House hates that sort of an arrangement, and I am not sure it exists in any other place in the Government except for the inspectors general.

So, the law as it was, and probably still is, is quite strong, that the advocate has a lot of power, and if he chooses to use that power certainly the authority is there.

Mr. SALMON. So is the problem that they don't choose to use the power, because it doesn't seem to me like—I don't hear from a lot of my small business owners in Arizona that this office is a tremendous advocate for them. That is the problem.

Mr. SANDERS. I would like to answer that too, congressman. I have always said that if they eliminated everything the agency did but the advocacy, at least they would be serving that purpose. I think it is the single most important role, but the administrator also fills a role as an advocate. The Advocacy Office has to not only advocate but collect data, economic data, that pertains to the small business segment of our country's business. The whole program, if I remember right, only costs about $4.5 million for all the salaries involved, and it is probably the sole source of steady collection of economic data affecting the business in America. I think that that office ought to be looked at for possible expansion.

When I was there, the chief counsel for advocacy and I had a wonderful relationship, we never had any conflict. Of course his budget comes out of our budget. We would talk about that from time to time. But I think that advocacy has to be assumed both by the administrator and the chief counsel for advocacy. It is a unique role, the chief counsel for advocacy, and he is supposed to see that the regulations that are passed on small business by other branches of Government are not those that hinder its formation.

Mr. SALMON. One other quick question that I have, and feel free, anybody that would like to answer it: Would we be better served, rather than have Government underwrite the losses of some of these SBA loans or the risk for these SBA loans, would we be better off to maybe provide financial incentives for banks to provide those kinds of risk guarantees on their own?

Mr. SANDERS. I can't imagine—it kind of goes back to what we were talking about a minute ago. I don't know what kind of financial incentives you would give a bank that might not produce greater losses and less flexibility when you deal with a Government guaranty. The full faith and credit of the U.S. Government is a very desirable investment to make, and that is why they pay premiums for those loan guarantees, and when you make the guarantee loan low enough that the bank is involved for a percentage of the risk, if the loan goes down they lose too. That combination seems to be the best way to get a lot of activity without having the Federal bureaucracy underwriting every loan. The direct loans were a disaster.

Mr. SALMON. I would agree.

Mr. SANDERS. Maybe you have an idea, I haven't heard one, where you can get the banks, give them an incentive, and get away from the guarantees, but that is what Mr. Foley was talking about a little earlier. We haven't found any way to privatize that.

Mr. SALMON. I am understanding, though, that with the existing loans, that it is supposed to be somewhat of a profit share over, what is it, over 10 percent on the bank loan.

Mr. SANDERS. Yes, there is a fee that goes on top.

Mr. SALMON. Yes. I don't believe that the Federal Government is sharing any of the profits on those loans. Correct me if I'm wrong.

Mr. SANDERS. I think you are talking about some of the new fees that have been imposed where, if you sell a premium over 110 percent——

Mr. SALMON. Right, if it is over 110 percent.

Mr. SANDERS. Yes, and there are some other fees involved.

Mr. SALMON. I understand they are never selling them over 110 percent.

Mr. SANDERS. It is amazing how that brought it down.

But there are other fees involved that the SBA gets on the lending activity of the bank too, so there are incomes that affect that subsidy rate that you have all heard about, that mystery figure.

Mr. SALMON. Right.

Well, thank you.

Mr. FOLEY. Could I comment, Mr. Salmon, on that?

Mr. SALMON. Yes, sure.

Mr. FOLEY. On that fee basis, this is something relatively new. In the secondary market, what we are talking about when you sell

the guaranty, if you have a $100,000 loan that is 90 percent guaranteed, that $90,000 is 100 percent guaranteed. It is almost like a Government bond. Even though it has the full faith and credit, because it doesn't have the terminology of a Government bond, it sells at a higher premium.

What is important in this, and I wish the SBA would reconsider this, is the effect that that fee has on the nonbank lenders. Let me explain what that is in case you may not be familiar.

Most of the loans that are made by the Small Business Administration are made through banks. However, there have been, I believe, 17 institutions that have been certified by the SBA to make loans that are not banks, and they get their money not through deposits, as a bank does, but by borrowing. In my own personal experience as a financial consultant I handle SBA loans for clients from time to time, and I have always found the nonbank lenders much easier to deal with because they are more knowledgeable.

A branch manager of a bank is used to short-term loans, personal loans, car loans, house loans but the nonbank lender is specialized. They understand the terms much faster, and by imposing these fee restrictions I think what they are going to do is make it more difficult for the nonbank lenders, less attractive for them to be in the program, I would encourage you to take a look at that, and I would hope that the Administrator would consider it.

Mr. SALMON. Thank you, Madam Chairman.

Chairwoman MEYERS. Mr. Hilliard.

Mr. HILLIARD. Thank you very much, Madam Chairman.

I have four questions, and really they are very short. I just want to make sure I understand where each one of you gentlemen is coming from.

Mr. Foley and Mr. Weaver, would it be a fair statement to say that each one of you essentially supports the basic function of SBA and feels that it should be retained?

Mr. WEAVER. It is true as far as I am concerned, yes, with maybe modifications.

Mr. FOLEY. Yes, I very strongly believe the SBA should be continued.

Mr. HILLIARD. Would it also be a fair statement that you feel that, because of the situation that does exist now, that it would be good perhaps, maybe with some modifications, to retain the 8(a) Program?

Mr. WEAVER. There again, I said in my statement that you might consider merging it with another program for efficiencies, but, yes, I think it should be maintained.

Mr. FOLEY. I believe it should be maintained, as I indicated.

Mr. HILLIARD. OK.

Now, Mr. Sanders, do you believe that basically the SBA should be continued?

Mr. SANDERS. Well, yes, nobody else plays that role as a defender and advocate of the small business segment of the country. However, I think, like every other agency in this Government, every part of the program should be reviewed now. I don't think all the programs should be continued in their present form.

Mr. HILLIARD. OK.

Do you believe that it is—with the advent of participation in NAFTA and GATT—that it is in the interests of this country for this Government to promote and assist small businesses?

Mr. SANDERS. Of course, all businesses.

Mr. HILLIARD. Well, do you really want Government assisting multinational corporations?

Mr. SANDERS. Well, I think that multinational corporations don't need much help.

Mr. HILLIARD. Then you are saying yes or no?

Mr. SANDERS. To which question?

Mr. HILLIARD. To the only one I asked: Do you think Government should assist multinational corporations?

Mr. SANDERS. Well, let's go back for a minute. Doesn't the Eximbank already assist them?

Mr. HILLIARD. Well, let me just clarify and make it easier for you.

Mr. SANDERS. I don't think they should hinder them. Let me put it that way.

Mr. HILLIARD. All right then.

But you wouldn't suggest that it is in the interests of Government, our Government, to assist multinational corporations on the same level as small businesses, would you?

Mr. SANDERS. No. I think small business has to have a special advocate and special treatment.

Mr. HILLIARD. Absolutely. In fact, there are certain segments of our country where we need to have certain incentives to—for all types of reasons, to promote small businesses. Isn't that correct?

Mr. SANDERS. That is correct, and particularly when it comes to minority people trying to get into the mainstream of business, they need particular help. I just don't think the 8(a) Program worked that well, at least when I was there, to do that.

Mr. HILLIARD. So, basically you are also in favor of, if not the 8(a) Program, but a similar program, one that would do the job. Would that be a fair statement?

Mr. SANDERS. One that gives real effective help to minorities to get into the mainstream on business, which has a lot to do with management assistance and that sort of thing.

Mr. HILLIARD. All right. So, basically you are not turned off about the concept of the 8(a) Program but basically about its operation.

Mr. SANDERS. That is correct.

Mr. HILLIARD. All right.

I take it for granted all three of you basically have objectives about the same, on your methods and your procedure you may differ. You all three believe in maintaining essentially the SBA, perhaps with some modifications, and the 8(a) Program, perhaps with some modifications.

Mr. SANDERS. Yes, I think the minority businesses have to be substantially helped in their technical and management assistance, and that certainly should include financial lending, that the lending should be across the board. I just simply said, in my experience, the 8(a) Program wasn't doing that.

Mr. HILLIARD. All right. Thank you very much.

I have just one other question. Last year we had a proposal before this committee to set up a secondary market that would deal with loans originated by the Small Business Administration very similar to the way we deal with FHA loans through Ginnie Mae certificates and that type situation, a secondary market. That would be, I guess, quasi-public. What would be your feeling on a similar marketing situation in terms of promotion, Government function in promoting the growth of small business, just overall?

Mr. SANDERS. What objection do you have to the way the secondary market works now in selling of the loan guarantees?

Mr. HILLIARD. I mean if you operate from the premises or you believe that small businesses still have difficulties in attaining capital, then to me you would want to create some vehicle that would enhance the opportunities.

Mr. SANDERS. But there is a secondary market for the loans now. They are sold in bulk, in $10 million lumps and such. Are we going to change that? I am not quite clear.

Mr. HILLIARD. Yes, I want a better market, a better vehicle, a greater one. That is the reason why I say similar to FHA and Ginnie Mae, because that market is very good.

Yes.

Mr. WEAVER. I have done a lot of work in that field, and actually the SBA guaranteed loan is a much better investment vehicle than either FHA or Ginnie Mae—not Ginnie Mae——

Mr. HILLIARD. Because of the higher percentage on the guaranty.

Mr. WEAVER. Well, it is full faith and credit.

Mr. HILLIARD. Yes.

Mr. WEAVER. Whereas you take Fannie Mae, that is nothing but a backup, it goes to $4 billion and that's it, and it is at the Secretary's discretion, whereas when you put a secondary market loan from SBA guaranty into the marketplace it is full faith and credit, so you don't need an agency to buy the loans, the public buys them, the institutions buy them, and I think that is one part that is working pretty well.

Mr. HILLIARD. Great.

Chairwoman MEYERS. Thank you.

Mrs. Smith.

Mrs. SMITH. This might have been addressed when I was gone. There is something I was interested in, and I think, Mr. Weaver, you addressed that, and that was the Disaster Programs, the disaster lending. I am interested in that. It seems to be something that could be used creatively sometimes maybe outside of its original intent. I think you alluded to the fact that it could maybe be privatized, and I think that was in your testimony, Mr. Weaver.

Could you tell me how you think you would come into that, given what is going on right now, and how you would start it if you could be king for a day.

Mr. WEAVER. Well, I don't think I said it could be privatized because I don't think it can be, it is a Government program first, last, and always.

Mrs. SMITH. OK.

Mr. WEAVER. The SBA got into it, backed into it. A big hurricane hit back in the—I guess after you left, Gene, down in Mississippi, and nobody could handle the volume of the lending, so SBA had

loan officers down there and they just gave it to SBA, and, fortunately or unfortunately, they did a good job and so we have been saddled with it ever since.

Every administrator said, "Why are we in the disaster business? What has this got to do with small business?" The answer comes back, "Well, you do a good job. By golly, you are going to keep it."

We tried during the Carter administration to get us out of the business by creating FEMA. I mean that was Carter's deal, and his idea was to—it started off as a coordinating agency, but to end up taking all the functions of disaster.

The people who make the loans, as Jim Sanders alluded to, are not regular SBA employees for the most part, there are 2,000 or 3,000 people who are temps, and if you have enough disasters they become almost permanent.

But it is a heck of a problem to keep the rolls of those people and keep experienced people coming back when you have a very large disaster like an earthquake out in California. All of a sudden, you have got to hire 2,000 people within a week. Golly, it just seems to me that SBA—and this may be treason to some SBA people—would be better off if they did not have disaster lending. First of all, it is off balance sheet lending; second, it takes a lot of time and effort away from its primary function, and that is helping small business.

Mrs. SMITH. So it brings in an element of crisis management as it comes in and destabilizes the agency.

Mr. WEAVER. Every disaster is a crisis.

Mrs. SMITH. So you would say that whoever handles that maybe should be looking at permanent employees, being as we are having permanent disasters by the time you look at all of them.

Mr. WEAVER. I think you could give the function of hiring those temps over to FEMA.

Mr. SANDERS. Yes. May I interrupt, Congresswoman Smith?

Mrs. SMITH. Sure.

Mr. SANDERS. In my statement there, I recommended that that is exactly what you do, take disaster out of the SBA and put it in a coordinated agency, and suggested FEMA.

The problem with FEMA, it seems to me, it was a great idea but it has never been given the kind of attention and support to really have a master strategic plan for what happens in the United States when you have a large disaster. Everybody scrambles around, and FEMA gives out grants, and SBA comes in with loans, and the Farmers Home Administration comes in, and the county comes in. It is a very mixed bag of things. There should be a plan ready.

Incidentally, we may have a disaster of an epidemic of some kind of virus across this country. I hate to mention it, but it could be a black plague or something. We have got to figure out what to do before it happens in helping people. That is what Federal emergency plans are for, and we don't have one, and I just don't think it is adequate if you just keep leaning on this agency or that one and run out and say, "Now do this, be a farm lender today." We get in trouble that way.

Mrs. SMITH. I guess the question that I have—and maybe it is broader than this being as it does go to emergency management, and we had a little one in my district with Mount St. Helens, and

that would be small compared to California right now, or whatever, but it did seem that whether it be rebuilding in the small business loans or whatever, that there were too many hands from different places, and so it does seem that even if you were to have to hire on a continuum a certain number of folks that deal with rebuilding the loan I mean giving the loans to whatever level, a family or small business or whatever, that it probably should be managed through the disaster, the whole coordination, and planned in advance.

An alternative to that though is, someone would say, "Well, you are keeping on employees you don't need all the time." So I guess what I would like to see is how those disasters have played into SBA and how much we have been spending reactionary and what it would cost to maybe maintain. Maybe that is what I should look at.

Mr. FOLEY. If I could just comment on that, I am not against the idea of transferring the Disaster Program to FEMA, but I think you would have to look at that very carefully. Disasters come and go, and when they have gone some of the personnel that have been assigned to the Disaster Program come back to the regular programs of the SBA. So, if they are all assigned to FEMA, that is something you would want to examine. I haven't thought it through myself, frankly, but I can see there might be full-time people not working full time.

Just for the historical record, Vernon, the hurricane that you are talking about, Hurricane Betsy, occurred on the day that I left SBA.

Chairwoman MEYERS. It sounds like you shouldn't have gone, Mr. Foley.

Mr. FOLEY. That was in August 1965, and I continued—actually, President Johnson asked me to continue supervising that, which I did. But prior to that, the first major disaster was the Alaska earthquake in April, 1964, which did occur when I was Administrator. So, it goes back at least that far.

Mrs. SMITH. Thank you.

Chairwoman MEYERS. Thank you.

Mr. Fields.

Mr. FIELDS. Thank you, Madam Chairwoman.

First let me thank the gentlemen for being here and thank them for serving their country during their tenure as administrator for the SBA.

Mr. Sanders, if you will, I would like to refer to a comment in your testimony. You said, "I am encouraged to see that the administration's proposal for the fiscal year 1996 has deleted $27 million in grants to specific communities whose elected representatives seem not to be in step with the express reforms of the new majority in Congress." My question is, these specific communities whose elected representatives seem not to be in step with the express reforms—what do you mean by that, sir?

Mr. SANDERS. Well, that $27 million that was put in there and then taken out by the administration's proposal is what I am referring to, it was spread over something like 15 different projects that were in local congressional districts. One was for an exotic research

laboratory on the study of genes or building a genome. These things have nothing to do with small business, and my point——

Mr. FIELDS. But for the sake of time, that is not my interest, in terms of the project, my interest in your statement is, elected representatives who seem not to be in step with the express reforms of the new majority in Congress. What do you mean by that?

Mr. SANDERS. What I mean by that is that this new majority in Congress——

Mr. FIELDS. And who are you talking about?

Mr. SANDERS. I am talking about the new majority in Congress in the House of Representatives and in the Senate that was elected in 1994, in the last election, who have expressed that they want to reduce the waste in Government.

Mr. FIELDS. I am familiar with who the new majority in Congress is. I am trying to find out who are these elected representatives that you pinpoint in your testimony.

Mr. SANDERS. Those who proposed those specific projects—and let me expand my comment. This is the way Congress has done business for many years. To get your vote, I say I am going to support your dam or your bridge, and you say I'll support your courthouse in your district, and we will put that in the Interior budget, and if it comes to the SBA, you do some of these other projects. But this new Contract With America, which is an expression of that new majority, said that we are going to get rid of that way of doing business, we are going to look at the national interest and we are not going to divide up all the local pork and pie. That is what that means.

Mr. FIELDS. Well, you have not answered the question, and I am not going to ask you to answer the question any longer.

Mr. SANDERS. Well, I have tried.

Mr. FIELDS. With all due respect, sir, let me say that I take issue with the fact that you would pinpoint members of this institution and say that their programs are pork programs, and though you mention one program in your testimony, the tree-planting program——

Mr. SANDERS. Yes.

Mr. FIELDS. Because this kind of testimony is a part of the Congressional Record.

Mr. SANDERS. Yes.

Mr. FIELDS. I just want you to know, as a Member of Congress, I take strong issue with that.

Mr. SANDERS. I am sorry, Mr. Congressman, you do, but thank goodness I don't have to stand here and represent an administration and I can speak as a private citizen. I support the idea that it this way of business, of trading off what we call pork—the only hope you have is to cut the port get the deficit reduced. I support that.

Mr. FIELDS. The reason I take issue with it, sir, is not because you made the statement, I take issue with it because when you leave a blanket statement out there and not call names then it makes every person on this side of the aisle somewhat vulnerable, but since you choose not to call names I am not going to ask you to call names.

Mr. SANDERS. I don't know what the names are.

Mr. FIELDS. Well, you said representatives. You said it very good. You said it very adequate in your statement. You said communities whose elected representatives seem not to be in step with the express reforms of this Congress.

Mr. SANDERS. Yes, that is right. The ones who put those projects in the budget, I don't know what their names are.

Mr. FIELDS. Let me ask you another question. You mentioned that eliminating the 8(a) Program would be a giant step in the reform in the SBA. Is that correct?

Mr. SANDERS. That is what I put down there, a very provocative statement.

Mr. FIELDS. Is it correct, or is it not? Do you believe that eliminating the SBA 8(a) Program would be a giant step in the reform of the SBA, yes or no?

Mr. SANDERS. I think that the 8(a)—we have gone through this. I am sorry that you weren't here, Mr. Congressman, but at the cost of repeating myself, when I was there the 8(a) Program was not serving the purpose of helping minority small businesses as it should have. It was helping rather large businesses that had grown to be big businesses, and that was why we had to graduate them. That was my impression.

Mr. FIELDS. So you feel eliminating the program would be a giant step in reform. Is that not correct? That is your testimony.

Mr. SANDERS. If you eliminate the program as it worked then, yes, that was my opinion. I think something else probably could replace it.

Mr. FIELDS. Let me ask you this question. When you were the administrator of the SBA, what was the function of the 8(a) Program?

Mr. SANDERS. The function of the 8(a) Program has always been, it seems to me, as written in the law, that it is to take certain people who were economically and socially disadvantaged and to give them preferential treatment in the contracting with the Federal Government, and when I was there we increased that contracting in our administration from $1.9 billion to over $3 billion in the 4 years I was there.

But my problem is that when I arrived I found that the program was dominated by a few firms in the group of 2,000 that were in the program, a few firms were taking almost all the contracting out of the program, and that is not what I think the intent of the 8(a) Program was.

Mr. FIELDS. So you increased it from $1.9 to $3 billion, and, of the increase, who benefited from that program? Was this, you said, preferential treatment, for what group of people?

Mr. SANDERS. Well, they were almost entirely black and Hispanic.

Mr. FIELDS. Women were not included?

Mr. SANDERS. No. We didn't look at women as a minority. We didn't see the sex difference, men or women, as a minority or majority. I still don't. I think the women's role in small business ownership is one of the most important and fascinating parts of the growth of business in America, and I think we have got to do everything we can to keep that going and enhance it, but they are not a minority.

Mr. FIELDS. You don't think women should be a minority?

Mr. SANDERS. I don't think they are a minority.

Mr. FIELDS. And they should not be classified as a minority?

Mr. SANDERS. No. Well, that is my opinion. It is not the definition of a minority. As a matter of fact, it is really a majority. I think there are more women in America than there are men.

Mr. FIELDS. So unless you are an Hispanic woman or a black woman, you shouldn't be classified as a minority, in your opinion?

Mr. SANDERS. Well, they come under the black or Hispanic classification, whether they are man or woman.

Mr. FIELDS. Exactly.

Mr. SANDERS. The sex is not important—the gender, rather.

Mr. FOLEY. If I could just comment there, I believe in some of the limited cases a woman can be classified as a minority if she can prove she is socially and economically disadvantaged. There is a presumption in the case of certain ethnic groups that they are socially and economically disadvantaged. If it is proven that they are not, then a member of that ethnic group is not socially and economically disadvantaged. So, some women, in fact, have qualified as socially and economically disadvantaged, but there is not a presumption there.

Chairwoman MEYERS. I think just to put some numbers in it—and I am doing this from memory so I could be wrong, but out of the several thousand people who have participated in the 8(a) Program over the history of the program, I think something like 20 of them have been Caucasian women, and most of them had to go to court in order to be considered socially disadvantaged, and of that number I think only about 400 have been minority women. It is virtually entirely a male program for some reason I have never quite been able to understand.

Mr. Metcalf.

Mr. FIELDS. I have not concluded. If I could conclude my remarks, Madam Chairman.

Chairwoman MEYERS. Yes.

Mr. FIELDS. So I just want to make sure I understand your testimony. Is your testimony that women should not, disadvantaged or otherwise, should be included in 8(a) Programs or any preferential program? Is that your testimony, sir?

Mr. SANDERS. Yes, that is correct, I don't believe because a person is a male or a female that is a minority situation or an economic disadvantage. As these gentlemen have pointed out, if you have to prove your economic and social disadvantage, I don't know if a white male has ever made a case for that, have they?

Chairwoman MEYERS. I don't think so.

Mr. SANDERS. Well, why not a white male, economic and social disadvantage? Then everybody would be a minority. Everybody would qualify for the program. I never thought of it that way.

Mr. FIELDS. My last question is, the 7(a) Program you are impressed with, as I appreciate your testimony, with one or two comments that were not as positive, but overall you generally supported the 7(a) Program as a means of getting money to businesses.

Mr. SANDERS. Yes. When I was there, there were a lot of critics of the program that said this guaranteed lending program does not increase the total pool of capital available to small business but,

rather, apportions it to people who are probably not as well qualified to borrow the money and will therefore misuse it.

I think that was totally think wrong. I think it does increase the pool of capital because you are using Government guarantees, and that regenerates the money, and I am really concerned, as I know these two gentlemen on my right are, that banks continue to be solicitous and concerned about the amount of small business loans they make. By nature small loans are not profitable because you have to load too many fees on top of them which become burdensome to the borrower. It is much easier as a banker, to make a $1 million loan than a $50,000 loan.

So, that is what we are dealing with. We have to keep the incentives there for banks to keep doing business with small businesses.

Chairwoman MEYERS. Mr. Metcalf.

Mr. FIELDS. We ought to make grants instead of the—we should have a program where small businesses could take advantage of grants versus loans?

Mr. SANDERS. I didn't understand.

Chairwoman MEYERS. I think we will have to pass on after this question.

Mr. SANDERS. Would you rephrase it? I couldn't hear it all.

Mr. FIELDS. In your testimony you said something about grants—you would prefer businesses being able to, small disadvantaged businesses, being able to take advantage of grants instead of having to take out small business loans. Is that not correct?

Mr. SANDERS. Yes. What I was pointing out was, in trying to get the banks into making loans in what are very tough situations economically like some of the inner city areas where the trade is not good, the crime rate is high, et cetera, I think that rather than have a failure of the banks to respond to that, you really ought to think about some kind of a grant or another approach to it. You need to do something about it, but I think forcing the banks in there would probably be a failure. That was just a comment that I made. It is provocative, but I think it is real, and it has to be regarded.

Mr. FIELDS. Thank you.

Chairwoman MEYERS. Mr. Metcalf.

Mr. METCALF. Thank you, Madam Chairman.

I do not have any questions. I do want to commend the panel, and I do have an extremely brief comment.

In my area, the Seattle-Everett area, the Small Business Administration has been doing, I feel, a really good job. An example: Gus Keehne, an employee of Western Forest Industries, was in my office yesterday. He wanted to stress the importance of the SBA Timber Set-Aside Program, probably not relative to the rest of the Nation but to that area. What it does is make certain amounts of timber available to small, traditionally family owned businesses.

I personally know that companies like the Buse Timber in Everett and Summit Timber in Darrington, Washington, and some others would not have survived without this Timber Set-Aside Program, and so as we look at the purpose, intent, and effectiveness of SBA as a whole, I certainly hope this committee will recognize and retain those programs that truly mean survival to our small businesses, and I thank you for the opportunity.

[Mr. Metcalf's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much.

Mr. Bentsen.

Mr. BENTSEN. Thank you, Madam Chairman.

A couple of things. Mr. Sanders, I was sort of following up a little bit on what Mr. Fields was talking about. Later on in your testimony you talk about the prospect of doing away with SBA and the transparency of any particular savings that might be gained from that because, while you might be able to gain $725 million on the one hand, on the other hand you just can't shut the doors and turn off the lights because you have a loan portfolio that needs to be managed, and I think that is very insightful on your part.

I think many of us need to take a look at that because many of my colleagues are saying, well, we can shut down this department and that department. I would add to the list HUD which has an even larger portfolio that somebody is going to have to pick up the pieces.

In the financial world I know that when you shut down a bank usually it is the FDIC that comes in and takes it over unless you can find a buyer, and I don't know who would do this if we shut down the SBA or HUD. So, I appreciated your comments to that.

Let me ask a couple of things. I think what Mr. Hilliard was getting at in his comments, and something that I have been interested in is the idea of seeing if we could take the secondary market for SBA loans—and you are right, there is a very ample secondary market—and actually increase it, and I would argue that the secondary market for Fannie and Freddie is pretty broad and perhaps broader. The credit is different, and that is certainly true, but if there was some way to explore—and I think when some of the others talk about privatization, I think that is maybe the privatization that we ought to look at where we can actually increase the amount of capital.

I would be interested in your comments on that, and then I have a couple of other questions, all of you.

Mr. WEAVER. I think I said this before. You probably weren't here, Congressman. There really is not a problem of selling guaranteed portions. The minute, for example, in Arkansas when I did a bank, we went to the State pension plan and they were delighted to buy all of them.

Mr. BENTSEN. I appreciate it. I know there is not a problem in selling it now. What I am thinking in terms of is actually increasing the amount of capital that is available if you can create a larger secondary market for it.

Mr. WEAVER. The way to do that is to increase the number of SBA loans made by the banks, and that just means interesting the bankers in making those loans. It is a very profitable sector of banking business if it is done properly.

Mr. SANDERS. A lot of them keep their loans.

Mr. BENTSEN. And don't remarket them, yes.

Let me ask quickly, if I might, with respect to the 8(a) Program and some of the contracting, there has been a lot of discussion in recent weeks about doing away with affirmative action, that its time has passed.

Obviously, Mr. Sanders talked about some of the problems that have occurred like in any program public or private where you are going to have some problems occur, and I think those problems should be corrected, but don't you all believe that there is some benefit—and I think that is what you have been saying this morning, and I would like to expand on that—to providing access to procurement, to building a minority small business base in the economy, and that it has some long-term benefits that the Government ought to be interested in?

As the second part of that question, I would like to ask if you have any thoughts—I believe the Congress and the administration in the past have revised some of the contracting rules to lessen the bid requirements on lower dollar contracts to speed up the process in terms of being able to get those contracts out, and I don't know if you have any comments on that, but I am more interested in the 8(a). Where do we go from here? Do you think that it is important that we are involved with that?

Mr. SANDERS. Yes. I put those comments in my statement. I knew they were provocative— what I am saying is, first of all, these were the experiences I had when I was administrator which I left in 1986. Today, even I have discovered a few new twists in the 8(a) Program that I hadn't heard about before.

But I think this program really needs some examination, if not exclusion. I have put it up there because these were the kinds of programs that detracted from the reputation of the SBA and the other good things it was doing. This program I didn't feel was working as well as it should. It wasn't getting to the real small minority businessman, it was dominated by big businessmen who had become big in the program and didn't want to leave.

Now evidently a lot of that has changed, but I would really examine the program, and I would get a group of black businessmen and Hispanic businessmen, mainly, to come in and consult. I haven't felt that the problem is in the Asian minority community. I don't see that that is a big part of it, and maybe I am outdated there, but more for the black business people in the cities, not so much the rural areas. I think if we sit down and chew this thing over and see if it really is accomplishing what it was supposed to without the hypocrisy and the graft that was in it—"graft" isn't a good word—pretense that is in it, many were not really a minority business, they were fronted. These things are not good.

Mr. BENTSEN. But you would agree that there is some benefit? I am not afraid to change, and I think we need to look at some of these programs, and changing them. I actually like your idea of bringing in the potential beneficiaries of the program and saying if this isn't working what will work, but would you agree that there is some benefit to that, that it does help our economy in the long run?

Mr. SANDERS. I believe one of the most serious problems we face in America is the fact that most of the black youngsters in the cities can't find a way out, through lots of reasons, and we have got to attend to that problem. They have got to be able to get jobs and start businesses and do things, and that requires a lot of stuff, like education, like background, like protection, crime suppression, all of those things.

Mr. BENTSEN. Economic development in terms of——

Mr. SANDERS. Economic development yes.

Mr. BENTSEN. In terms of developing an enterprise base.

Thank you, Madam Chairman.

Chairwoman MEYERS. Thank you, Mr. Bentsen.

Mr. Longley will be our last question questioner, and I would like to just take this opportunity to thank you all so very much for being here. I think you have given us a real perspective over the history of the SBA, some very important contribution.

Mr. Longley.

Mr. LONGLEY. I will just end on this note.

I am a freshman, and I am learning that we have a Government that spends money it doesn't have, regulates beyond the ability to enforce a regulation, and also schedules people to be in three and four places at the same time.

I have had a chance to read through your testimony, and I have got a question I would like to direct to both Mr. Weaver and Mr. Sanders, particularly Mr. Weaver, and it is the same general question, and I will make a specific reference to each of your testimony, and then I would appreciate any thoughts you have.

Mr. Weaver, you made reference to privatization candidates and elimination candidates; and, Mr. Sanders, you made some comments relative to where there could be effective economies realized and changes in the SBA, and I think, frankly, we are at a point where we need to look at an agency that was created 42 years ago and assess the extent to which it is meeting the needs of business today, and I am very interested in the concept of: First, what programs should we be eliminating or terminating or scaling down; and, second, I am fascinated by the concept of either privatization or perhaps block grants or more orientation to the specifics of State and local areas.

Representative Metcalf made reference to a timber set-aside program, which again sounds as if it was specific to the needs of the business community in that geographic area, and so under the broad heading of where should we be cutting or looking at trimming back, where can we be privatizing or exploring new initiatives by which we can, consistent with existing revenue constraints, more effectively serve the needs of small business?

Mr. SANDERS. The area that the management assistance area is so vital to new businesses, to startup businesses, people who are considering going into business, entrepreneurship, but I think most of that can be delegated, a lot of it at least, to the private sector, so long as the SBA has some oversight into what is going on and some kind of role perhaps in coordination. I also think a lot of that can devolve upon the States.

I think some of the things that the SBA started in assistance centers, some of them at universities, some at community colleges, and some through State agencies and chambers work well. In many programs, the State and the local operation puts up matching funds with the Federal Government, and it seems to me that if those things are working well the locals should take them over while Congress has some oversight.

When I was administrator we did a lot of private sector partnership with the telephone companies, with IBM, with other people.

Those people had the real expertise into the new generation of management and management information and. I think there is no way the Government is going to be better at that than they are. We ought to let them take the lead. That is the privatization that I am thinking about that works now.

Mr. WEAVER. I also said management assistance was the most reasonable one to privatize and also to do everything you can to privatize the lending function by letting the banks take over, letting the banks make the loans. In some cases even without supervision.

There's also some internal stuff, and I just threw out a couple of possibilities. We have an advocate, and we have a minority small business department which is an advocate for minority small business. It seems to me they could be combined and let them do the whole job for the whole spectrum.

The 8(a) used to be part of our procurement assistance program. Public Law 95–507 moved it out. Maybe it is better in times where you are looking at your dollars a little more closely to put them back together and have one manager do them both and bring that all the way down the agency, you might eliminate quite a few duplicative jobs, and there are other areas in the agency the same thing could apply.

Mr. LONGLEY. Mr. Foley and Mr. Baldwin.

Mr. FOLEY. I think you may want to take a look at the small business development centers. Now I know that they have a great constituency, but in my limited experience I don't know whether the taxpayer is getting its money back on that one. So, that is one you maybe want to take a look at.

I would recommend that you call in the leaders of the small business investment companies to discuss the technical possibilities of privatizing that industry. I don't think you can privatize the 7(a) Program. I think it would be a disaster for small business in this country. I haven't made up my own mind on the SBIC Program, but I think it is worth a look.

Before we break, Madam Chair, I would like to make a comment somewhat off the subject of what we have been talking about, but I won't do it right now.

Mr. LONGLEY. Mr. Baldwin, would you want to respond to the question?

Mr. BALDWIN. I didn't think it had a particular emphasis in the U.K.

What I would say, the one thing I still would like to see in the U.K. is an advocacy program. One really does need someone within Government who does represent small business amongst the departments of state, as we call them. It is very easy, I think, for small business to be concentrated in one area of Government and for the other Government activities not to recognize the concerns of small business.

We have a deregulation program. We now have people in each department of state who are looking at regulations, past and future, to ensure that they don't impinge on the ability to carry out business and the costs of complying with those regulations, which affect small business more than large, do not, again, dampen down enterprise.

But we do need advocacy, and I have always felt your advocacy role within the SBA is fundamental. If you are going to discriminate in favor of small business, you need that individual and his team to represent them within Government.

Mr. LONGLEY. Thank you.

Thank you, Madam Chairman.

Chairwoman MEYERS. Thank you, Mr. Longley.

I would like to thank you very much, Mr. Baldwin. I know that you are a long way from home, and we wanted to hear from you so much that we really made an attempt to schedule this hearing when you could be here, and we appreciate it very much, and I think we have all learned a great deal.

I wonder if I could ask this. I have some questions, but I would like to frame them, and if maybe I submitted them to you in writing you could either just write me a short note, call me with the answer, whatever is convenient for you.

Mr. FOLEY. Could I just add something, Madam Chair?

Chairwoman MEYERS. Yes.

Mr. FOLEY. It will only take 2 more minutes. More and more small companies are involved in international trade and international business, and I don't think either committee, either the House Small Business Committee or the Senate Small Business Committee has ever really looked at the attitudes of these international lending agencies toward small business. Now the Export-Import Bank is first rate. They have a very active pro small business program, but you ought to take a look at it anyhow.

OPIC, the Overseas Private Investment Corporation, is just beginning to take a look. But there is a whole other area of international lending that are not U.S. Government agencies but for whom the largest contributor to their existence is the U.S. Government. I have in mind the World Bank, the International Finance Corporation, the Inter-American Development Bank, the European Bank for Reconstruction and Development, the African Development Bank, the Asian Development Bank. All of these have a U.S. executive director and a staff that represent U.S. interests. We can't insist that they adopt U.S. policies because they are international agencies, but I do think we have a right to ask them what are their policies toward small business, how do they affect small business. I don't think anybody has ever taken a look at it.

Chairwoman MEYERS. I think that is an excellent suggestion, and we will do that.

I did introduce a bill last year that called for an assistant secretary of trade in the USTR's office that would focus solely on small business, because I don't think that we have the attention to small business exports that we should and I don't think we encourage it adequately. If we are going to overcome trade deficits, we are going to have to encourage our people, and most of our large businesses are exporting now. That means the increase is going to have to come from small business.

But that is excellent suggestion for a hearing, and we will follow through on it.

Mr. BALDWIN. Madam Chairman.

Chairwoman MEYERS. Yes.

Mr. BALDWIN. May I suggest you concentrate on Germany. They are the world's biggest exporter, and their so-called "mittlestand" companies that employ between 50 and 500 not only I think contribute about 70 percent of their GDP, they contributed 30 percent, I think, of their direct exports as well as being suppliers to their major companies. I personally am very impressed by what the Germans have done to bring their small businesses up to the middle size and to also be the driving force behind their exports.

Chairwoman MEYERS. An excellent suggestion.

Again, thank you all.

Do you have a last comment, Mr. Sanders, and then we will adjourn.

Mr. SANDERS. Yes. My last comment. Everybody wants a last comment.

Thank you very much for having us here, Madam Chair, and my last statement is, don't let anybody tell you that putting the small business advocate or the office or operation in the Department of Commerce or any place else is going to work. It is either going to be the SBA, or they shoot it down in cold blood, because it won't work anywhere else.

Mr. WEAVER. I second that.

Chairwoman MEYERS. Well, I thank you very much. Thank you.

[Whereupon, at 12:20 p.m., the committee was adjourned, subject to the call of the chair.]

APPENDIX

Opening Statement of
The Honorable John J. LaFalce
Ranking Minority Member
Committee on Small Business

Hearing on the History, Mission and Function of the SBA
February 28, 1995

Thank you Madame Chairman for calling this hearing.

For the newer members of the Committee, the testimony we hear will probably be their first opportunity to hear in some detail the rationale for establishing the SBA and how the agency has adapted its mission and functions to changing times, increasing demands, and diminishing resources.

As someone who has worked on small business issues for a number of years and who, as Chair of this Committee, oversaw the establishment and performance of many SBA programs, I anticipate that the Committee will come away with the sense that this is an agency that serves a real and ongoing need for a large and vital segment of the U.S. business community -- a segment which in turn is an enormous and economically influential part of the overall U.S. economy.

As we know, the Small Business Administration's legislatively established mandate is to aid, counsel, assist and protect the interests of small business. This is done in a variety of ways -- including financial assistance, disaster assistance, business development assistance, and small business advocacy.

It has carried out this mission since it was created in 1958. It has not, however, carried it out in exactly the same ways throughout these 37 years.

The business world of 1995 is a different animal in almost every sense than the one that existed when the SBA was established. The technology, transportation, workforce, competition,

products and services that a small business owner confronts today did not exist 3 decades ago. And the SBA has responded to these developments. As SBA Administrator Phil Lader remarked the other day: "Just as they tout in the commercial, 'this is not your father's Oldsmobile.' Well, this is not your father's SBA." From paperwork reduction for loan applications to caps on guarantees, the SBA keeps striving to be being business-friendly in its objectives yet business-like in its methods.

At the same time, business basics have remained the same: an ongoing need for capital; assistance in competing for government contracts; and expert advice in helping someone who has a viable product or service but does not know the intricacies of applying for a bank loan or writing a business plan. The SBA continues to respond to these needs -- and is the only agency doing so.

Is there still a reason for having an agency dedicated to small business issues? I believe the answer is yes. This is not just a one-way street helping small businesses. The benefits of assisting small businesses spill over: the government, for example, can get better prices and products through innovation and increased competition in procurement, and secures more revenues through the jobs created.

Moreover, as Rosabeth Moss Kanter, a Professor of Business Administration at the Harvard Business School, observes, the United States has been moving from corporatism to entrepreneurialism and large corporations are trying to emulate the focus, speed, flexibility, and agility of smaller ones. If small business is a successful model for today's marketplace, it is clearly in the interest of the U.S. government to continue to strengthen, maintain, and facilitate it.

The SBA is not problem-free. No agency is. I think improvements can be made, and the

upcoming series of hearings on SBA programs may suggest some changes that will improve services while keeping intact the SBA's ability to carry out its basic mission.

Thank you, Madam Chairman.

Opening Statement of Rep. Jan Meyers
February 28, 1995

On January 6, I pledged to the nation's small business community that our committee would hold a detailed set of hearings, which will include a program by program analysis of each and every program at the Small Business Administration. This morning is the first of those hearings. As it is the first, I asked the staff to arrange a hearing which would give the committee as broad an overview of the SBA as possible.

At today's hearing, we will hear from three past SBA Administrators whose tenure encompasses the era from the middle 1960's through the middle 1980's and the political attempt to entirely eliminate the agency. The Honorable Eugene Foley served both Presidents Kennedy and Johnson at the SBA. The Honorable Vernon Weaver ran the SBA under President Carter and also during that period oversaw the first White House Conference on Small Business. The Honorable James Sanders

served President Reagan at the SBA and withstood the political firestorm when there was a movement to eliminate the agency. These three gentlemen, the committee will find, have a great deal of wisdom to share with us as well as a tremendous amount of most refreshing candor.

Our final witness, who has worked with Mr. Weaver and others over the years is the distinguished Barry Baldwin from London, England. Mr Baldwin has been an instrumental force in the United Kingdom since the late 1970's in the restoration of small business in the economy and within the government there. As everyone can see from his fascinating 91 point statement, he will present a very eloquent case of what can happen in a major industrialized nation when the government makes no effort to aid, counsel, and assist small business.

This morning's hearing will give all the Members an excellent opportunity to learn much about both small business and the SBA, as well as the opportunity to question four superb experts in this field.

Committee on Small Business
The House of Representatives

Opening Remarks
of
The Honorable Glenn Poshard

February 28, 1995

I would like to thank Chairwoman Meyers for scheduling what will be an informative series of hearings examining many of the Small Business Administration's programs. I look forward today to hearing from three of the Small Business Administration's former chief administrators, the Honorable Eugene Foley, the Honorable Vernon Weaver, and the Honorable James Sanders. I believe each of you have had in your role as SBA Administrator an important impact on the SBA's past and continued successes. I equally anticipate hearing testimony from the Honorable Barry Baldwin of London, England on the recent reemergence of the small business community in the United Kingdom. It is a pleasure to have you all here with us today.

I believe it is important that as we examine the Small Business Administration and its many functions, we remember the many successes the SBA has had in creating jobs and stimulating local economies across the country. Often critics of the SBA fail to recognize the idea that the SBA is an investment in the American worker and entrepreneur. For every dollar Congress invests in the SBA, we are putting at least five dollars back into the economy.

I am a strong advocate of balancing the federal budget, but I also understand the difference in cutting back or eliminating programs that do not work and investing in those that do. I believe the SBA is an example of one of those government programs that is working for the people of our country. My hope is that during this series of hearings the committee can look at additional ways to make the SBA and its programs even more successful.

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Foreword

1 In a world of increasing specialisation, where it is often better to put peripheral services out to contract rather than to attempt to deploy the expertise oneself and where many major corporates are concentrating on core activities; major industry must have available to it a comprehensive range of smaller, independent specialist firms.

2 At the same time there is an important role in the economy for smaller firms, which are not suppliers to large firms, to ensure a variety and quality of products and services, both to consumers and other smaller firms in their own country and also, to a lesser extent, to those in other countries.

3 Smaller firms are vibrant, innovative and adventurous. They are a crucial source of new ideas, products and services. They are the seedbed from which the larger companies of the future will grow.

4 Starting up and running smaller firms give people a stake in business and increases self-reliance, so helping to underpin a free society and to create greater social balance. This can have profound implications for the political and social fabric of the country.

5 Smaller firms create wealth and jobs in local communities; their owners are committed to those communities, they will not "up sticks" if the going gets tough. They give balance to the overall economy by increasing the number of independent decision makers and reducing the size and impact of such decisions.

6 Ownership is one of the vital motors of wealth creation. Ambitious and proud owners of unquoted companies will drive the economy forward. They recognise the concept of building private economic enterprise for the longer term. The UK needs more people starting their own businesses but, importantly, more business owners putting their existing success at risk and seeking to grow their companies.

7 Smaller firms are critical to the health of the UK economy. They were at the core of Britain's confident enterprise culture which was revived and returned in the 1980s. Confidence is a very frail quality and the UK must not lose that spirit of enterprise. Independent companies can provide jobs and stability in the 1990s, stimulating growth and prosperity, reviving again the enterprise culture following the recent recession.

A look back to 1980

8 The smaller business sector had been in long term decline for some fifty years. The decline in the sector had been matched by increased economic concentration in the UK, which was a major obstacle to the creation of an economic climate in which smaller independent businesses could survive, thrive and prosper.

9 Large businesses continued to invest more and more in capital intensive methods of production and, increasingly, it was no exaggeration to say that the prospects for employment, as well as for economic growth, rested to a considerable extent in the hands of the proprietors of smaller business.

10 Such businesses would not instantly create the national wealth, absorb the unemployment, or solve the problems of innovation, but it was clear that they could make a considerable contribution in each of these areas.

11 The problems which had to be overcome in the UK were deep-rooted. Having been the pioneers of the Industrial Revolution the UK allowed the new big factory system to drive out the traditional manufacturing methods, which had their reliance on the master craftsmen or independent businessmen of that age. Other countries which followed the UK path, realised the folly and took positive steps to avoid it.

12 In the mid-nineteenth century, when the UK monopolised world markets, as the major capitalist nation, politicians and business leaders looked with indifference at the misery suffered by the UK's craftsmen, judging it to be a matter of course caused by the logical achievement of free competition sustained by economic law.

13 For too long the interests of smaller firms were largely ignored in the belief that the promotion and development of major corporations, in a modern economy, is for the benefit of industry as a whole and the country in general.

14 This contrasted directly with the position in the United States where small businesses were seen as the foundation of national security and free competition, which is vital to a private enterprise system. The United States had a Small Business Act some thirty years old which placed an obligation on the Federal Government to aid, counsel, assist and protect small businesses. In the UK there was no such Government understanding and support.

15 Japan, for its part, had a basic Small Business Act and fifteen other major Acts on small business. The emphasis in Japan was less on competition and much more on eliminating the barriers associated with smallness. This amounts to what we would call positive intervention in favour of smaller firms to ensure that resources were allocated on the optimum basis. Japan, with twice the population of the UK, had five times as many small firms as the UK.

16 West Germany had an explicit small business policy without comprehensive legislation. The emphasis in Germany was not simply on understanding the need for competition and innovation but, more importantly, for preserving social balance. Post-war Germany had been determined to avoid another alliance of a dictatorship and big business. Germany appeared to have avoided the polarisation between big and small firms, unions and management, and the general "us" and "them" mentality which had crippled social consensus and economic performance in Britain.

As a result, although the relative economies of the UK and West Germany were about the same size, West Germany had over forty per cent more small businesses than we had in the UK.

It had to be appreciated that the UK did not have any comprehensive legislation on smaller enterprises nor was there apparently any major piece of legislation in the UK which was specifically directed at such firms. Furthermore there had been no clear policy framework towards smaller business and inevitably this had resulted in a smaller commitment of resources and a less elaborate range of measures than in any other comparable country.

Not only did the UK not have any basic small firm legislation but Government machinery for looking after small business was inadequate for the task. In this connection the UK did not even have one hundred per cent of the time and effort of the one Junior Minister who was given special responsibility for small firms There were middle ranking ministers - Minister of State - for such matters as Health, Consumer Affairs and Overseas Aid, but not for Smaller Businesses. No member of the Cabinet had day to day responsibility for such firms. The Small Firms Division in the Department of Industry numbered some forty people but its German equivalent had about two hundred.

There was a need for an effective body to defend and represent smaller businesses. We had no Agency, to use an American phrase, to provide the advocacy role for smaller businesses - this was seen by many in the UK as the most effective part of the Washington bureaucracy for such firms.

There was no part of the UK Government machine which would say - "that regulation may be OK for large firms but it is no good for smaller firms because it will damage them".

Furthermore, there was no machinery or legislation which existed to create fairer competition between all sizes of businesses and to ensure that all existing and proposed legislation and regulations were properly scrutinised to determine and then justify their impact on smaller firms.

Machinery did not exist in Government to ensure that smaller businesses received a fuller and increasing share of national and local Government purchasing contracts.

Central and local Government expenditure of all kinds in the UK accounted for about fifty per cent of our Gross Domestic Product. Increased spending by Government carries a threat to smaller firms because there is a tendency to centralise public purchasing departments to place contracts with large suppliers who are able to meet bulk requirements.

This tendency is reinforced by the fact that large firms are likely to be better informed about Government purchasing needs and better able to cope with the paperwork, controls and regulations which accompany such purchasing.

In most other countries it is true to say that the share of smaller firms in public purchasing is lower than their share of national output, suggesting that the growth of Government has been a depressing factor on the role of smaller firms in the economy. It was for this reason that it is necessary for Government to take active steps to ensure that small firms receive a fair share of all Government purchasing.

It was well known that in the United States a specific percentage was set by Congress for Government purchasing from smaller firms. West Germany and France also took positive steps to ensure that smaller firms receive preferential treatment in this area.

More recently in the United States smaller firms had also been guaranteed a larger share of Federal Research and Development contracts to assist smaller, high technology firms.

The problem in the UK was we did not even know what was the level of purchasing from smaller firms by central and local Government.

However, the advent of the first Thatcher Administration in 1979 brought a sea change of attitudes towards smaller firms in the UK. It became better understood in the UK that the decision to start and run a small business was a decision to pit your wits against the outside world, possibly to accept hardship and to struggle to create wealth where it did not exist before.

These are the qualities - the willingness to stand on your own feet, to be a maker rather than a taker - which were fundamental to the success of the whole of the UK in the 80s. However, there is a danger, even within the present Government, of the belief that enough had already been done to encourage smaller firms.

What became clear, following the initial surge of measures to encourage smaller firms, after decades of neglect, Government could not then simply sit back and believe it had done enough. The challenge to which it responded with such enthusiasm, was a continuing commitment to aid, encourage and protect smaller firms.

It was understood that there was no cheap or easy way of ensuring that the excessive decline in the smaller business sector that had taken place in the UK could be reversed fundamentally. Massive Government intervention was not wanted, neither could it be justified.

The priorities of policy were re-ordered to encourage the British people to replenish the nation's wealth instead of squandering it. This was of particular importance when one considered the breathing space that the UK had been given as a result of North Sea Oil.

A paragraph from George Gilder's book "Wealth and Poverty" said it all - "The United Kingdom must overcome the materialist fallacy; the illusion that resources and capital are essentially things that can run out rather than products of human will and imagination, which in freedom are inexhaustible. This fallacy is one of the oldest economic delusions, from the period of Empire when men believed that wealth was land, to the period of mercantilism, when they fantasised that it was gold, to the contemporary period when they assume it is oil. Two of the most thriving of the world's economies lost nearly all their material capital during World War II and surged back by emancipating entrepreneurs"

The current situation

The UK Economy

36 The UK is the ninth largest economy in the world, the fifth largest trading nation and stands to be a major beneficiary of the successful conclusion of the GATT Uruguay round. The UK has a 6% share of world trade in services and a 5% share of visible trade. In terms of visible exports, the UK exports 20% more per head than Japan and 85% more than the US.

37 The UK's relative performance improved during the 1980's. This was the first decade since the war in which the UK economy grew faster than Germany, France and Italy. Manufacturing productivity,a key determinant of competitiveness, grew faster than any of the other major industrialised economies, narrowing the productivity gap with our competitors. After decades of decline the UK's share of manufactured exports stabilised during the mid 80's.

Growth in the 1980s

38 The 1980's saw a remarkable growth in the number of firms in the UK. From 1.8 million firms at the end of 1979 the number rose to 2.9 million by the end of 1989, a rise of 60%. Since the vast majority of firms are small, there was a correspondingly large increase in the number of small firms.

The main elements of the changes in the small firms sector are:

A 70% increase in self employment from 1.9 to 3.25 million.

Over 400,000 new business start-ups per year.

A disproportionately high share of new job generation by small firms.

Position in the 1990's

39 Small firms have retained their vital role in more difficult times.

40 In 1991, the last year for which estimates are available, the total number of UK businesses stood at 2.7 million, 50% higher than in 1979.

41 Start-ups have remained high, with nearly 400,000 new firms per year.

42 Job generation studies continue to show small firms' importance.

43 Self-employment peaked at 3.3 million in 1990. It now remains fairly steady at about 3 million.

A number of factors help to explain the rapid growth in the number of small firms in the eighties. These include:

44 A structural shift away from manufacturing and towards service sector industries which accounts for a disproportionately large number of small firms. The fastest rates of growth occurred in finance, property and professional services and other services. These two sectors alone accounted for over 50% of the increase in VAT registered businesses in the 1980s.

45 Technological developments in the manufacturing sector in areas such as micro electronics, computing, telecommunications and information technology. These have spawned a host of new products and processes particularly suited to exploitation by small firms. For example, UK small firms were responsible for generating 64% of significant innovations in the computer industry in 1983.

46 Changes in the behaviour and organisational structure of large firms. There has, for example, been an increase in subcontracting activities, management buy-outs and franchising, all of which provide opportunities for new small firms to start up. The contracting out of business service activities in particular, played an important role in new firm formation during the early eighties.

47 Government policy also had a noticeable impact on the small firms sector. The promotion of an enterprise culture, for example, helped to create a positive image of self-employment. Over 400,000 people a year were prepared to take the risks involved in starting a business in the eighties, reflecting a real change in attitudes towards the small firms sector and towards enterprise generally.

48 More direct policy initiatives, such as deregulation and changes in the taxation system, were also instrumental in creating an environment conducive to the start-up of small firms.

International comparisons

49 The growth of the small firms sector has been substantially more rapid in the UK than in other countries, including the United States and Japan. As a result, the relative size of the small firms sector in the UK is now much closer to that in other countries than it was at the beginning of the 1980s.

50 The hard evidence on international comparisons is patchy, but it all tends to support this assertion. The rate of increase in (non-agricultural) self employment in the UK was over 75% between 1979 and 1991 and was substantially greater than that in other countries. As a result, the self-employment rate in the UK in 1991, 11% is now only a little below the European Community average of 13% and is very close to that of Japan.

51 A report for the European Commission in 1994 estimated that the share of employment in small businesses in the UK was less than the Community as a whole, but the differences were small. In manufacturing, the UK has a smaller proportion in employment in small and medium sized firms.

Rationale for Government support for smaller firms

52 The UK Government believes that business works best when given maximum freedom to operate in a competitive market. The success of the economy as a whole and the smaller firms sector in particular, depends on creating the climate and culture in which enterprise can flourish and is rewarded.

53 In any market economy, the primary responsibility for improving competitiveness lies with business itself. Markets, however, do not always work efficiently and whilst market failure may affect all firms, smaller firms face particular problems. Larger firms, for example, often benefit from economies of scale.

54 The identification of market failure is a necessary but not sufficient justification for Government intervention. The question needs to be asked whether intervention will improve UK competitiveness, whether intervention would not further distort the market. Whilst the processes of competition themselves inevitably cause some enterprises to fail, improvements in the environment in which smaller firms operate can enhance the creation and growth of businesses.

55 Because of their value to the economy, the Government takes the view that a light touch on the steering wheel of market forces is necessary to ensure that smaller firms are not unduly disadvantaged by their size.

56 Government policy in relation to smaller firms focuses on three areas:

(1) creating a favourable economic climate
(2) reducing bureaucratic burdens on business
(3) providing direct assistance where required.

57 Creating the right economic climate for smaller firms means keeping inflation low, reducing interest rates and keeping them low, simplifying and reducing the burden of taxation. Low and stable interest rates are of particular benefit to smaller firms because they are generally very reliant on short term loans. Successive Budgets have provided further practical support and encouragement to people setting up in business and smaller firms already working hard to survive and grow. Particular tax incentives have been created to encourage outside investment and re-investment of rolled over capital gains.

58 Unduly burdensome legislation and bureaucratic controls - whether imposed by central Government, local Government or by Brussels - can cause particular difficulties for smaller firms. Complying with legislation and with administrative regulation is costly in terms of time and other resources, particularly for the sole trader. De-regulation, that is to say, the simplification or removal of unnecessary regulations which affect all business but weigh most heavily on small businesses, continues to be a major element of Government smaller firms policy.

59 There are occasions when legislation may be needed to protect smaller firms. "The Deregulation and Contracting Out Act" will put into effect changes in existing primary legislation and establish a framework for simplifying future legislation.

60 There are three main areas in which the need for direct assistance from Government for smaller businesses has been identified:

(1) access to finance
(2) training and management skills
(3) business information and advice.

61 Smaller firms are naturally cautious about putting their existing success at risk. They may often simply not be in a position to finance new projects even if these offer a potentially good return. This problem is particularly acute for the small high technology firm which may lack both financial and physical collateral. For the smaller firm in particular, getting it wrong may mean going out of business. For the economy as a whole, there is a double loss. In practical terms, failure means the loss of revenue and there is the less tangible but no less important loss of ideas and skills.

62 The disproportionate cost to banks and other financial institutions of assessing small tranches of loan or equity finance discourages investment in smaller firms. Smaller firms themselves, when considering re-financing are often prepared only to approach a bank. Their owners may well fear that outside equity, for example, might undermine their control of their business, always assuming that they can offer a high enough return to be attractive to venture capitalists.

63 To help technology-based businesses that have problems financing development projects in their early stages, the Department of Trade and Industry operates two schemes - SMART (Small Firms Merit Award for Research and Technology) and SPUR (Support for Products Under Research). In conjunction with the banks and other lenders, the DTI's Loan Guarantee Scheme addresses the problems of small firms needing finance but lacking security or a track record.

64 The Government recognises that small firms need access to training, advice and support at a local level and wherever possible, tailor-made to meet individual needs. In England, the new "Business Links" spread across the country will in future be the main vehicles for the delivery of business support for both new businesses and those wishing to grow, with Training and Enterprise Councils playing a strategic role in developing and adapting services to local needs.

65 In a world where competitive advantage is increasingly dependent on networking between firms of all sizes and on cohesion between public and private business support agencies, the "Business Link" network will meet the need for a national, high quality, support framework. "Business Links" will provide Personal Business Advisers to work alongside managers, diagnosing problems, offering consultancy in innovation, technology, design and export services and providing access to a wide range of support packages. They will play a major role in helping firms to achieve their potential, to thrive and grow.

66 Small firms play a vital role in a healthy economy. They help to stimulate competition in sectors which would otherwise be dominated by large well-established firms, exerting a downward pressure on prices and extending consumer choice. They are flexible and innovative and they create both employment and wealth and contribute to the UK's ability to produce the goods and services which help to create a prosperous nation.

Looking ahead - the manufacturing challenge

67 The UK is unusual and atypical amongst G7 nations. Its listed companies have a stock market value about equivalent to 100% of GDP. In the US, the role model of Anglo-Saxon capitalism, the figure is about 60%. In France and Germany it is about 30%.

68 Another unusual feature of the British economy is the large scale of inward investment. To an extent the room for such investment in the UK has been created by the failure of British business in so many industry sectors. Such investment also confirms that the British worker is likely to be as good - or as bad - as his management.

69 The UK has the largest concentration of economic power in a relatively small number of very large companies compared to other advanced industrialised countries. Over 200 of the top EC500 companies are British. However, there has been a steady erosion of these giant companies following the pressure of recession and as increasing technological progress comes to bear.

70 In manufacturing, less than 2% of all UK enterprises employ more than 500 people. They account for almost two thirds of manufacturing output and 60% of total manufacturing employment. Firms with fewer than 100 employees account for 94% of all manufacturing enterprises, and of this size class 70% are firms with fewer than 10 employees.

71 The firms employing over 1,000 people have increased labour productivity faster than the other size classes so that the productivity gap in favour of large enterprises has grown in the 1980s.

72 In all classes but the smallest, employing fewer than 10 people, the total number of enterprises has been in steady decline over the period since 1963. These declines have been particularly sharp for firms employing more than 1,000 employees. The UK's manufacturing employment has reduced significantly over the period. Prior to the recession, West Germany had been able to almost maintain its corresponding employment whereas the United States had increased its manufacturing employment.

73 UK firms employing less than 500 people have increased their relative national importance in terms of output and of employment since 1979, and this is true for firms with between 100 and 500 employees as well as for those firms with less than 100 employees.

74 The growth in the relative importance of smaller firms is common to all major European countries, with the UK in the early 1980s, lagging only behind Italy in terms of the increase in shares of output and employment in enterprises employing between 20 and 99 people.

75 What is disturbing is that the number of UK enterprises employing between 50 and 500 employees should have declined over the period between 1963 and 1985 and that the UK share of activity in this group is apparently low by European standards. This is precisely the range in which one would expect to find companies with the best prospects for rapid growth to significant size. A shrinking pool of such companies gives cause for concern.

76 The UK's share of world markets in manufactured goods has halved over the last twenty years. During the same period America and West Germany have lost a little whereas Japan has increased its share. On the other hand imports to the UK have gone up by over 50%.

77 In the 1980s UK consumer expenditure rose by 3.4% annually in real terms whilst gross domestic product climbed by only 2.3%. Production output growth averaged 1%, with exports rising by 3.4% annually against import volumes of 5.3%

78 The UK problem is that we have been importing too many goods which we should be manufacturing ourselves. Our overall investment in manufacturing is too low. Indeed, Britain's investment record is poor by international comparison. West German, French and American manufacturers spent about 50% more than their British equivalents on new plant and industrial premises for each employee during the 1980s. The Japanese spent almost three times as much.

79 British manufacturing productivity, a key measure of competitiveness, has shown encouraging gains, some 60% in the last 10 years, and it is continuing to rise. But there remains a substantial productivity gap between the UK and its main rivals, in part due to lower skill levels. Not only does the UK need to achieve still greater productivity gains but also it needs to increase its underlying productive capacity.

80 Research indicates three areas of concern - skill training, research and development, as well as the cashflow cost of capital - this recognises both the rate of interest and the repayment term of the finance. The latter concern helps explain why the UK economy has been transformed from one based on manufacturing to one with greater emphasis on services and retailing where capital requirements are lower. As such, it tilted too far towards services in the 80s, whereas the economy must be more balanced.

81 One thing is certain, the service sector alone is not the key to full economic recovery by the UK. Service industries cannot replace the lost earnings and jobs in manufacturing because many services depend on manufacturing for their existence. Only 20% of the service sector can export its products directly, whereas some 85% of UK exports are manufactured goods.

82 Wealth creation and job availability are needed throughout the whole of the UK, not merely in centres of financial services, which are primarily concentrated in the South East. Manufacturing is necessary for the political, social and economic needs of the country.

83 Average rates of interest in the UK during the 1960s were 6% to 7%, in the 1970s just over 11%, whereas in the 1980s they were over 15%. In addition, because the UK's average loan periods are less than those of Germany and Japan, the combined rate of interest and shorter repayment terms create a significantly higher cashflow cost of capital in this country than in those two competitor countries. In the UK an investment will therefore have to pay for itself over a substantially shorter period and must therefore be capable of earning a higher annual return to be attractive.

84 Health and safety regulations are evidently policed more vigorously in the UK than in most of the other EC member states. The British Government should continue its campaign to ensure that harmonised laws are enforced consistently across the Community, otherwise additional costs will be added unfairly to those businesses in countries where policing is effective.

85 At the same time the UK Government should continue its drive to reduce red tape and free business from unnecessary regulation, which increases costs and interferes with the efficient running of smaller firms. A culture change is necessary - we have to avoid zealous officials interpreting and enforcing legislation to the detriment of business. At all times we should be asking "What are the costs? Are the costs to business justified by the risks to the public"?

86 There is also a need to look again at the financing of exports by UK manufacturers. Export Credit Guarantee cover used to be available which enabled short term finance to be raised at preferential rates. This cost effective mechanism has now been discontinued. Concern also exists about longer term export contracts where progress payments are not available. Banks do not always understand such contract finance, particularly when an independent manufacturer is involved. For these UK exporters to maintain competitiveness financing needs to be more simple and cost effective.

87 Independent manufacturers can also experience difficulties in raising finance for research and development due to the uncertainty of its outcome. More recently, the Inland Revenue appears to be adopting a harsher line on development expenditure attempting to insist that abortive costs, in addition to the positive costs, incurred on new product development should be capitalised. This is totally illogical. All R & D expenditure should be 100% tax deductible to encourage increasing development and innovation.

88 There is also the perennial cultural problem of late payment of debt by UK customers, which adds significantly to working capital requirements of independent manufacturers. No consensus exists on the action to be taken to overcome this difficulty. In such circumstances legislation for statutory interest is not the answer and is unlikely to be effective in competitive situations. Undoubtedly there is a need for further Government review of the situation to try and seek a solution.

89 There is a need to restore the confidence of manufacturing business leaders and owners, as well as their work people, reassuring them in their contribution is vital to the economic wellbeing of the country. Those in manufacturing have been under sustained stress for a lengthy period. Greater effort is needed to encourage people "to stand at a lathe" and to recognise their value, which is as fundamental to the success of manufacturing as is the role of those who put in the money.

90 But what the UK needs most of all are more manufacturing companies and greater manufacturing investment - the UK has been guilty of allowing a once strong manufacturing sector to decline. It needs a larger manufacturing base - greater productivity gains alone are inadequate to redress the problem. Only an enhanced base can underpin a strong economy, achieving an increasing level of exports and of products to compete successfully with imports.

91 Thankfully, we have moved away from the mid 80s perceived wisdom that we can rely solely on the services sector to provide economic growth. The challenge now is to stimulate our manufacturing base.

BARRY ANTHONY BALDWIN

- Age 60
- Fellow of the Institute of Chartered Accountants in England and Wales.
- Associate member of the Institute of Directors.
- Partner, Price Waterhouse, 1969-1991, including seven years as head of the London Independent Business Services Group, setting up and two years as partner in charge of the Windsor office, four years as National Director of Independent Business Services and two years with responsibility for these services throughout Europe. Chairman of the Price Waterhouse World Emerging Business Executive 1990-91.
- Seconded Member of the Conservative Research Department advising on smaller business policy (1980-82).
- Rapporteur's Expert, Economic and Social Committee of the European Communities (1983, 1985 and 1986).
- Chairman of the Union of Independent Companies; representing small and medium sized manufacturers (1986 and 1987).
- Special Adviser, Small Firms Minister (1991-92).
- Member, Lambeth, Lewisham and Southwark Area Health Authority (1980-82).
- Member, Lewisham, and North Southwark District Health Authority (1982-83).
- Special Trustee, Guy's Hospital (1976-93).
- Inaugural Chairman of the 3i Communication Club (1993). (3i is largest investment capital company in Europe)
- Head of Research, Small Business Bureau (current).
- Executive Member of the Union of Independent Companies (current).
- Deputy Chairman, Theatre Royal, Windsor (current).
- Member of Court and Council, Cranfield University (current)
- Non-executive chairman/director of four private companies (current).
- Equity investor in five private ventures.

OUTLINE OF TESTIMONY REGARDING THE SMALL BUSINESS ADMINISTRATION

by Eugene P. Foley
Administrator, SBA,
Aug. 1963-Aug. 1965

I. Fundamentals of Small Business Finance

A) Types of Capital
- 1-Equity
- 2-Debt
- 3-Hybrids

B) Uses of Capital
- 1- Working Capital
- 2- Fixed Assets Financing

C) Sources of Capital
- 1-Public Markets
- 2-Private Offering
- 3-Venture Capital Companies
- 4-Angels (friends, relatives)
- 5-Insurance Companies
- 6-Government Sources - Federal States, Local
- 7-Finance Companies
- 8-Leasing Companies
- 9-Banks & S & L's
  - a) Short term deposits
  - b)Short term lenders

II. Summary History of the SBA
- a) Reconstruction Finance Corp. (RFC), 1931
- b) Creation of SBA - 1953
- c) Johnson Administration - 1964
  - 1-Delegation of lending authority
  - 2-Guarantee Program

III Statistics of SBA Lending
- a) Volume - in dollars; in number
- b) Terms of a loan - years; interest rate; guarantee fees

IV Necessity of SBA
- Source of long term lending for small business

V Possibilities of Privatization
- a) Banks
- b) Insurance Companies
- c) Others

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EDUCATION

High School	St. Felix High School, Wabasha, Minnesota, 1942-1946.
Military	United States Infantry, 1946-1948.
College	B.A., St. Thomas College, St. Paul, Minnesota, 1948-1952; Institute of EuropeanStudies, Vienna, Austria, 1952.
Graduate	L.L.B., University of Minnesota Law School, Minneapolis, MN, 1955

PROFESSIONAL

1955-59	Practiced law, Foley & Foley, Wabasha, Minnesota.
1959-61	Legal Counsel, U.S. Senate, Small Business Committee, Wash., DC
1961-63	Executive Assistant to U.S. Secretary of Commerce, Wash., DC
1963-65	National Administrator, US Small Business Administration, Wash., DC
1965-66	Assist. Secretary for Economic Devel., U.S. Dept. of Commerce, Wash., DC
1967-69	President, Interore Corp., Subsidiary of Occidental Chem. Corp., NY, NY
1969-71	Vice President, Dreyfus Corp., Manager of Mutual Funds, NY, NY
1971 —	Financial Consultant for Small and Medium-sized Companies.

PAST BOARDS

1969-79	National Bureau for Economic Research, NY, NY
1971-75	Mercy College, Dobbs Ferry, NY
1972-86	National Council for Urban Economic Devel., Wash., DC, (Co-founder)
1972-78	Municipal Art Society, NY, NY
1976-81	National Committee on American Foreign Policy, NY, NY, (also President)
1980-85	Lehigh Valley Industries, NYSE, NY, NY

CURRENT BOARDS

1968-Present	African-American Institute, NY, NY
1986-Present	Board Member, Numerous Privately Held Corporations

AWARDS AND PUBLICATIONS

1965	Arthur Flemming Award, awarded annually to the ten outstanding young persons in Federal Government. (Awardees included: Paul Volcker, Daniel Patrick Moynihan and Robert Jastrow.)
1965	International Boss of the Year Award, National Secretaries Assn.
1966	Government Man of the Year Award, National Business League.
1966	Honorary Doctor of Laws, Lowell University, Lowell, MA
1966	Author: *The Negro Businessman--In Search Of Tradition* — History of the Black Businessman in Philadelphia, PA; Daedalus.
1968	Author: *The Achieving Ghetto* --Book on the economic development of minority ghettos.
1974	Distinguished Service Award, National Council for Urban Economic Development. (awarded also to Senator Hubert H. Humphrey).
1986	Honored by CBS- Network TV Program, "PORTRAIT OF AN AMERICAN," Feb & Aug, For Having Created The SBA Program, SCORE (Service Corps Of Retired Executives).

STATEMENT OF

THE HON. JAMES C. SANDERS

BEFORE THE

HOUSE SMALL BUSINESS COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

FEBRUARY 28,1995

MADAME CHAIRMAN AND DISTINGUISHED MEMBERS OF THE HOUSE SMALL BUSINESS COMMITTEE, I AM HONORED AND PLEASED TO BE INVITED TO THIS HEARING.

THE SBA HAS ATTRACTED MUCH CRITICISM AND EVEN RIDICULE STEMMING FROM EGREGIOUS AND SOMETIMES CRIMINAL ABUSE OF ITS PROGRAMS. MUCH OF THIS HAS STEMMED FROM MEMBERS OF CONGRESS AND THE ADMINISTRATION USING THE SBA AS THE DUMPING GROUND FOR LOCAL DISTRICT PROJECTS. MANY OF THE PROGRAMS WERE WELL-INTENTIONED, BUT IMPRACTICABLE. MOST WERE TOUTED AS TEMPORARY SOLUTIONS BUT THEY REMAINED AND BECAME OUTDATED.

MY COMMENTS HERE ARE DESIGNED AS AN OVERVIEW OF THE COMPONENT PARTS OF SBA--THEIR FUNCTIONS AND COSTS. MY OPINIONS ARE SHAPED BY MY FOUR YEARS ('82 TO '86) AS ADMINISTRATOR. I HOPE IT WILL BE PARTICULARLY USEFUL TO NEW MEMBERS OF CONGRESS AND I WOULD BE PLEASED TO RESPOND TO ANY QUESTIONS BY MAIL, FAX OR PHONE.

AT THE SENATE CONFIRMATION HEARING ON MY NOMINATION AS SBA ADMINISTRATOR ON MARCH 9,1982, I STATED, "WE CANNOT SIMPLY PROCEED BY GOING THROUGH THE MOTIONS WITH PROGRAMS DESIGNED... FOR THE 1950's OR 1960's... IF THE SBA REMAINS STATIC AMID CHANGING TIMES AND MAJOR CHALLENGES, IT WILL LOSE ITS REASON TO EXIST."

ALTHOUGH WE SUCCEEDED DURING THE SUBSEQUENT FOUR YEARS IN SQUEEZING DOWN THE WASTEFUL DIRECT LENDING PROGRAM AND ENFORCING GRADUATION FROM THE 8-A PROGRAM, OTHER PROGRAMS FROM THE 50's, 60's, AND 70's REMAIN.

OUR EFFORTS TO CUT THE FAT IN THE EARLY 80's WERE OFTEN OPPOSED BY A CONGRESSIONAL LEADERSHIP WHICH VIEWED FEDERAL PROGRAMS AS THE PIPELINE TO PLOW MONEY BACK HOME AND SECURE THEIR OWN RE-ELECTIONS. NOW COMES THE 104TH CONGRESS WITH AN EXPRESSED DETERMINATION TO PRUNE BACK AN OVERGROWN AND MEDDLESOME BUREAUCRACY... TO KICK THE ADDICTIVE HABIT OF DEFICIT SPENDING. MARK THIS AS THE SINGLE MOST IMPORTANT PROGRAM FOR THE GROWTH OF SMALL BUSINESS, FOR THE GROWTH OF ALL BUSINESS, FOR JOBS AND FOR EVERY AMERICAN'S FUTURE.

TO INSIST ON THIS FISCAL DISCIPLINE SENDS A SIGNAL OF HOPE THAT WE HAVE NOT ACCEPTED THE INEVITABILITY OF INCREASING DEBT AND INTEREST PAYMENTS THAT ROB THE GOVERNMENT BUDGET OF FLEXIBILITY AND FOREORDAIN MASSIVE INFLATION AS THE ONLY WAY OUT!

REDUCTION OF THE DISCRETIONARY PART OF THE ENTIRE FEDERAL BUDGET BY 200 TO 250 BILLION DOLLARS IS AKIN TO RADICAL SURGERY THAT ACCEPTS SHORT-TERM PAIN TO SAVE THE PATIENT. EACH AGENCY AND EACH DEPARTMENT, EACH PROGRAM MUST BE CHALLENGED TO THE CORE. THE QUESTIONS MUST BE ASKED:

1. SHOULD IT BE DONE AT ALL?

2. CAN'T THE PRIVATE SECTOR DO IT BETTER?

3. SHOULDN'T THE INDIVIDUAL STATES ASSUME THE RESPONSIBILITY?

4. HOW MANY OTHER PROGRAMS DUPLICATE THIS ONE?

5. CAN THE FEDERAL GOVERNMENT RETAIN OVERSIGHT WITHOUT THE COST OF THE PROGRAMS?

APPLYING THESE QUESTIONS TO THE SBA WOULD, IN MY OPINION, PRODUCE DRAMATIC REDUCTIONS. AT THE OUTSET, LET US FOCUS ON THE TOTAL COST (BUDGETED OUTLAY) OF THE AGENCY IN THE 1995 BUDGET, EXCEPTING THE DISASTER PROGRAM. THE TOTAL IS 725 MILLION DOLLARS. CONTRAST THAT WITH THE AUTHORIZED LEVEL OF FINANCIAL PROGRAMS OF 11.5 BILLION DOLLARS, OF WHICH 7.8 BILLION ARE GUARANTEED LOANS THROUGH BANKS AND OTHER FINANCIAL INSTITUTIONS. THE POINT IS THAT ALTHOUGH SBA OVERSEES PROGRAMS THAT GENERATE BILLIONS OF DOLLARS OF ECONOMIC ACTIVITY (e.g. LOANS AND PROCUREMENT CONTRACTS), THE COST OF THE AGENCY IS LESS THAN A BILLION DOLLARS, EXCEPTING DISASTER LENDING.

SO, IF YOU ELIMINATED THE ENTIRE AGENCY IN THE NEXT FISCAL YEAR, YOU MIGHT THINK YOU WOULD REDUCE THE DEFICIT BY 725 MILLION DOLLARS. BUT YOU WON'T, BECAUSE YOU HAVE TO CONTINUE TO MANAGE THE LOAN PORTFOLIO OF ALMOST 30 BILLION DOLLARS AND PAY THE LOSSES. WITH A CONSERVATIVE ESTIMATE, THIS COULD WIND DOWN AT 270 MILLION DOLLARS PER YEAR, PLUS 15 MILLION IN MANAGEMENT EXPENSES FOR THE NEXT 10 YEARS, PERHAPS IT COULD BE GIVEN TO THE TREASURY, BUT IT WILL COST THE SAME. YOU WILL ALSO HAVE OFFICE SPACE TO MANAGE AND THE SEVERANCE

EXPENSES OF 4,000 CIVIL SERVICE EMPLOYEES. THESE RUNOFF COSTS ARE UNAVOIDABLE IN EACH AGENCY WHERE YOU HAVE DETERMINED THAT THE PROGRAM OR AGENCY IS NO LONGER COST EFFECTIVE.

HAVING GIVEN THE THUMBNAIL SKETCH ABOVE, IT IS MY OPINION THAT THE SMALL BUSINESS UNIVERSE WHICH GENERATES MOST OF THE NEW JOBS AND CONTRIBUTES ALMOST HALF OF THE G.D.P., NEEDS A WATCHDOG ON THE FEDERAL GOVERNMENT. THIS IS PRINCIPALLY THE FUNCTION OF THE ADVOCACY OFFICE OF THE SBA, AND THAT OPERATION PRESENTLY COSTS ABOUT 5 MILLION DOLLARS PER YEAR. THE PRIMARY MISSION OF ADVOCACY IS TO INTERCEDE WITH THE APPROPRIATE AGENCIES, THE WHITE HOUSE AND CONGRESS WHENEVER REGULATIONS, TAXES, OR OTHER PROPOSALS ARE BEING CONSIDERED. I ALSO BELIEVE THAT CONGRESS MUST RETAIN OVERSIGHT ON SMALL BUSINESS MATTERS THROUGH THE SMALL BUSINESS COMMITTEES OF THE HOUSE AND SENATE.

IN THE FINANCIAL SUMMARY OF SBA ABOVE, I EXCEPTED THE DISASTER PROGRAM. THAT PROGRAM DOESN'T BELONG IN THE SBA ANY MORE THAN IT BELONGS IN COMMERCE OR GSA. ALL THE EMERGENCY RELIEF ACTIVITIES OF THE FEDERAL GOVERNMENT SHOULD BE CONSOLIDATED IN F.E.M.A. DURING MY TENURE, I WAS CONSTANTLY STRUGGLING TO KEEP THE SBA OUT OF NON-PHYSICAL DISASTERS SUCH AS FARM CROP LOSSES, PESO DEVALUATION LOSSES, AND FISHING HARVEST LOSSES FROM EL NINO IN THE PACIFIC NORTHWEST. THE PRESSURES FOR THESE PROGRAMS CAME FROM CONGRESSMEN WHO FELT THE SBA WAS THE EASIEST PLACE TO DEPOSIT ONE MORE COSTLY PROGRAM.

I AM ENCOURAGED TO SEE THAT THE ADMINISTRATION'S PROPOSAL FOR FISCAL 1996 HAS DELETED ABOUT 27 MILLION DOLLARS IN GRANTS TO SPECIFIC COMMUNITIES WHOSE ELECTED REPRESENTATIVES SEEM NOT TO BE IN STEP WITH THE EXPRESSED REFORMS OF

THE NEW MAJORITY IN CONGRESS. THE TAINTED REPUTATION OF THE SBA RISES LARGELY FROM SUCH PORK BARREL ACTIVITIES AS THESE.

SOME YEARS AGO, A CONGRESSIONAL LEADER WANTED TO START A NEW JOBS PROGRAM SO HE AUTHORED A TREE PLANTING PROGRAM. WAS THIS PROGRAM PLACED WITH THE AGRICULTURE DEPARTMENT OR THE INTERIOR DEPARTMENT? NO, IT WAS PLACED IN THE SBA WHERE HE HAD THE LEVERAGE. FOR YEARS THAT PROGRAM HAS BEEN RENEWED IN THE SBA AND IT NOW CARRIES A 15 MJMILLION DOLLAR PRICE TAG.

ANOTHER PROGRAM THAT HAS CREATED AN INORDINATE AMOUNT OF BAD PUBLICITY FOR SBA IS THE MINORITY ENTERPRISE DEVELOPMENT PROGRAM, BETTER KNOWN AS THE <u>8-A PROGRAM</u>. IT HAS BEEN MARKED OVER THE YEARS BY FRAUD AND ABUSE. PART OF THE REASON FOR THIS IS THAT CONGRESS WOULD NOT FUND THE KIND OF OVERSIGHT PROGRAM THAT WOULD INCLUDE OUTSIDE AUDITS, PREFERRING INSTEAD, TO USE IT TO CREATE A WELL-HEALED CONSTITUENCY THAT DID VERY LITTLE FOR BEGINNING MINORITY BUSINESSES, ELIMINATING THIS PROGRAM FROM THE SBA WOULD BE A GIANT STEP IN REFORM.

THE SMALL BUSINESS DEVELOPMENT CENTER (<u>SBDC</u>) IS A JOINT PROGRAM WITH THE STATES. SBA DISTRIBUTES ABOUT 70 MILLION DOLLARS IN MATCHING GRANTS TO THE STATES. ITS PURPOSE IS TO PROVIDE CENTERS WHERE SMALL BUSINESSES ARE PROVIDED MANAGEMENT AND TECHNICAL ASSISTANCE THAT REFLECT THE LOCAL NEEDS AND INDUSTRIES. HERE IS A PROGRAM THAT IS FEDERALISM IN CONCEPT AND COULD BE DEVOLVED UPON THE STATES WITH THE FEDERAL FUNDING PHASED OUT OVER TIME. THE INDIVIDUAL STATES WOULD THEN ASSUME THE SUBSEQUENT FUNDING. THIS PROGRAM HAS BEEN WELL-MANAGED BY THE SBA AND A PRODUCTIVE PATTERN HAS BEEN SET IN MOST OF THE STATES.

IN ADDITION TO THE SBDC'S, MANAGEMENT ASSISTANCE IS PROVIDED THROUGH THE VOLUNTEER EFFORTS OF THE SERVICE CORPS OR RETIRED EXECUTIVES (SCORE). THEY MANAGE ONE-DAY SEMINARS FOR THOSE CONSIDERING A START-UP BUSINESS AND IT IS ONE OF THE MOST USEFUL PROGRAMS IN THAT IT PREVENTS NOVICES FROM MAKING COSTLY AND TIME CONSUMING BLUNDERS BY HAVING THEM CAREFULLY CONSIDER THE COMMITMENT THEY MUST MAKE TO A SMALL BUSINESS - "LOOK BEFORE YOU LEAP". THIS PROGRAM WITH HUNDREDS OF EXPERIENCED VOLUNTEERS COSTS 3.3 MILLION DOLLARS PER YEAR. THE SMALL BUSINESS INSTITUTE (SBI) PROGRAM IS ALSO ONE OF MINIMUM COST AND IS DELIVERED THROUGH COLLEGES WITH BUSINESS STUDENTS COMPOSING A SEMESTER STUDY OF A LOCAL SMALL BUSINESS. THE END-RESULT IS AN ANALYSIS AND RECOMMENDATION FOR THE BUSINESS.

THE PROCUREMENT PROGRAM SEEMS TO HAVE BEEN OVERLOOKED IN MUCH OF THE DEBATE ABOUT SBA's FUTURE. THE SBA, FOUNDED IN 1953, WAS THE OUTGROWTH OF THE SMALL DEFENSE PLANTS ADMINISTRATION WHICH WAS CREATED IN 1951 TO INCREASE SMALL BUSINESS PARTICIPATION IN THE KOREAN WAR EFFORT. IT ACCOMPLISHED THIS BY MONITORING FEDERAL PROCUREMENT TO SEE THAT SMALL BUSINESS WON A FAIR PROPORTION. THE SBA THEN WAS CHARGED TO "... AID, COUNSEL, ASSIST AND PROTECT, INSOFAR AS IS POSSIBLE, THE INTEREST OF SMALL BUSINESS CONCERNS... TO INSURE THAT A FAIR PROPORTION OF THE TOTAL PURCHASES AND CONTRACTS ... FOR PROPERTY AND SERVICES FOR THE GOVERNMENT BE PLACED WITH SMALL BUSINESS ENTERPRISES". AT THAT TIME PROCUREMENT WAS THE MAIN MISSION OF THE SBA AND TODAY THAT PROGRAM OVERSEES 42 BILLION DOLLARS ANNUALLY IN FEDERAL CONTRACTS AWARDED TO SMALL BUSINESS ON A COMPETITIVE BASIS. THE OPERATING COSTS FOR THIS PROGRAM IS ABOUT 20 MILLION DOLLARS. THERE IS EVIDENCE THAT IN DEFENSE PROCUREMENT THE SMALL BUSINESS PARTICIPATION HAS BEEN A MONEY SAVER. WOULD IT HAPPEN WITHOUT

THE WATCHDOG ROLE OF THE SBA? MY EXPERIENCE SAYS, "NO". IS IT WORTH THE 20 MILLION DOLLARS IN JOBS AND TAXES PAID ON 40 BILLION? I THINK SO.

AS AN ADJUNCT TO PROCUREMENT, THE SMALL BUSINESS INNOVATION AND RESEARCH PROGRAM (SBIR) HAS HAD GOOD REVIEWS. THIS PROGRAM ENABLES INDEPENDENT INVENTORS AND RESEARCHERS TO GET AN OPPORTUNITY TO BID ON THE GOVERNMENT R AND D CONTRACTS. THIS, AGAIN, IS AT A MINIMUM COST--PROBABLY LESS THAN ONE MILLION DOLLARS.

FINALLY WE COME TO THE LARGEST PROGRAM OF THE SBA IN TERMS OF MONEY AND MANPOWER. THIS IS THE FINANCE AND INVESTMENT PROGRAM WHICH ACCOUNTS FOR ABOUT 350 MILLION DOLLARS IN THE OUTLAY BUDGET--ABOUT ONE HALF OF THE ENTIRE SBA BUDGET. OF THIS ABOUT 250 MILLION DOLLARS IS THE COST OF THE GUARANTEED LOAN PROGRAM(SECTION 7-A). AGAIN, I HAVE ELIMINATED THE DISASTER PROGRAM FROM CONSIDERATION.

THIS GUARANTEED LOAN PROGRAM IS A PARTNERSHIP WITH THE PRIVATE SECTOR. WHEN THE BANKS ARE TRULY SBA's PARTNERS, ASSUMING SOME OF THE RISK ON EACH LOAN, THE PORTFOLIO LOSSES WILL NOT BE OUT OF LINE WITH AVERAGES IN THE INDUSTRY. BUT AT 90% GUARANTEE, THE BANKS ARE WITHOUT RISK FOR THEY CAN SELL THE LOAN GUARANTEE AND RECOVER THEIR 10% WITH THE PREMIUM ON THE SALE PLUS THE SERVICE FEE. THAT IS WHY WE INITIATED THE PREFERRED LENDER PROGRAM AT 75% GUARANTEE. I BELIEVE THIS PROGRAM MAKES A SUCCESSFUL CONTRIBUTION TO THE NEED FOR CAPITAL BY WELL MANAGED SMALL BUSINESSES.

THE MOST DISTORTED CHARGE AGAINST THE SBA LENDING PROGRAM IS THAT IT DOESN'T SERVE A SIGNIFICANT PERCENTAGE OF THE SMALL BUSINESS COMMUNITY. THIS IS

LARGELY BASED ON THE FALSE ASSUMPTION THAT ALL SMALL BUSINESSES ARE SEEKING BANK LOANS EACH AND EVERY YEAR.. THE REAL TEST IS WHETHER THERE IS A MEANINGFUL GAP IN LENDING THAT SHOULD BE FILLED AND IS THE SBA IS FILLING IT ON A PROFITABLE BASIS. THIS PROBABLY APPLIES TO THE LONGER TERM LENDING.

IT IS MY OPINION THAT SMALL LOANS WITH 90% GUARANTEES TARGETED TO ECONOMICALLY DISTRESSED AREAS WILL PRODUCE UNACCEPTABLE LOSS RATIOS WHICH WILL, IN TURN, TAINT THE ENTIRE LOAN PORTFOLIO. IT WOULD BE MORE STRAIGHTFORWARD TO ACKNOWLEDGE THE HIGHER RISK AT THE OUTSET AND MAKE IT A GRANT PROGRAM UNDER SOME AGENCY SUCH AS FEMA OR, BETTER YET, LET THE STATE AND LOCAL GOVERNMENTS TAKE THE INITIATIVE, I WOULD ALSO CHANGE THE LENDING CAP OF $ 500,000. TO A CAP ON THE GUARANTEE INSTEAD OF THE LOAN SO THAT A BANK COULD INCREASE ITS EXPOSURE. IN OTHER WORDS, A BANK COULD MAKE A MILLION DOLLAR LOAN AND HAVE A 50% GUARANTEE.

AS YOU REVIEW THE SBA AND OTHER AGENCIES, KEEP IN MIND THAT THE "AGE OF INFORMATION" WITH VAST AMOUNTS OF DATA INSTANTLY AVAILABLE THROUGH NETWORKS OF PERSONAL COMPUTERS MUST FINALLY CHANGE THE WAY BUREAUCRATS WORK; JUST AS IT IS DOING IN THE PRIVATE SECTOR. LET US CONSIDER THAT WE CAN ABANDON SOME OFFICE COMPLEXES AND PROVIDE THE ESSENTIAL SERVICES WITH A CIVIL SERVICE EMPLOYEE WHO WORKS MORE EFFICIENTLY FROM HIS HOME. FURTHERMORE, HE IS TO BE JUDGED ON THE VOLUME AND QUALITY OF HIS WORK AND NOT JUST THE HOURS HE IS PUTTING IN!!

IN CONCLUSION, SMALL BUSINESS NEEDS A WATCHDOG AGENCY ON THE FEDERAL GOVERNMENT. IT MAY BE OPERATED FOR A FRACTION OF WHAT IT NOW COSTS BUT SMALL BUSINESS IS TOO IMPORTANT AS THE INCUBATOR OF NEW GROWTH TO RISK A CRIB DEATH

BY ELIMINATING TRULY EFFECTIVE PROGRAMS.

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RESUME OF JAMES C SANDERS

FEBRUARY,1995

1992 TO PRESENT :

- CONSULTANT ON BUSINESS DEVELOPMENT
- TRUSTEE, MONTEREY INSTITUTE OF INTERNATIONAL STUDIES
- DIRECTOR, SMALL BUSINESS FOUNDATION OF AMERICA

1986 TO 1992 :

- PRESIDENT OF THE BEER INSTITUTE, A NATIONAL TRADE ASSOCIATION

1982 TO 1986

- ADMINISTRATOR OF THE U S SMALL BUSINESS ADMINISTRATION

1979 TO 1982

- CEO OF CORROON& BLACK / /SANDERS & SULLIVAN INSURANCE BROKERS

1951 TO 1979

- FOUNDER AND PRESIDENT OF THE STARTUP FIRM OF SANDERS AND SULLIVAN

1949 TO 1951

- JUNIOR CIVIL ENGINEER, PETER KIEWIT SONS CONSTRUCTION COMPANY

EDUCATION

- BACHELOR OF SCIENCE , CIVIL ENGINEERING, UNIVERSITY OF KANSAS
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- ENLISTED IN U S NAVY IN 1944 HONORABLY DISCHARGED AS A ENSIGN IN 1947 WITH LAST DUTY STATION AT SANGLEY NAVAL AIR STATION, PHILLIPINE ISLANDS

Statement of A. Vernon Weaver

Former Administrator of Small Business Administration

before the U.S. House Small Business Committee February 28, 1995.

It was my honor to serve as Administrator of the Small Business Administration ("SBA") for four years under President Jimmy Carter. President Carter had received a small business loan in the late 1960s and additionally had received considerable assistance from a member of SCORE (The Service Corps of Retire Executives). He was very favorably disposed towards the SBA which made my job considerably easier .

As I understand it this hearing is being held for the purpose of determining whether or not the SBA should be continued in its present state, reorganized by eliminating or merging certain of it's programs or discontinued altogether. I will list the common perceptions and complaints that I have heard as Administrator and in the 13 years since I left office: then I would like to address each of them:

1. A person must be a minority to receive any benefits from the SBA.
2. SBA Guaranteed Lending (7a) is off budget financing and therefore should be abolished.

3. There is too much bureaucratic red tape.

4. The loss ratio of SBA lending is too high.

5. Entrepreneurs cannot get loans from the SBA.

Discussions of each of the above:

1. This is completely untrue. During my time at SBA we had great difficulty in meeting our goals for minority lending. These goals were based upon population figures.
2. SBA Guaranteed Lending is backed by a revolving pool which is used to pay losses. This revolving pool is funded each year by an appropriation. This appropriation is actuarially determined so that monies will be available in the future to pay off bad loans. The presumption of off balance financing could only be true to the extent that the revolving pool is inadequate: therefore, this claim is spurious.
3. I will cover this at length at the end of my statement.
4. Guidelines for SBA's loss ratio have never been provided by the Congress. Since SBA is a lender of last resort one would expect

that loss ratios would be considerably more than those for a commercial bank. Banks try to keep loss ratios at the 1% level and SBAs losses have averaged 6-8%. While I was Administrator we calculated that the loss ratios that would be incurred if loans were no longer made would be in the neighborhood of 10%. If this is not an acceptable level the Congress may wish to establish guidelines in the future.

5. This claim is a canard. Virtually all SBA loans are in fact made to entrepreneurs. Each time a loan is turned down the applicant becomes angry and may call his Congressman or complain to other authorities. Most of these loans are turned down because the loan officer cannot be assured that the loan will have a reasonable probability of repayment.

It is my opinion that, if the committee questioned each former administrator, it would find agreement on two things. First, the agency should be continued and second, that some programs should be merged and others should be eliminated.

I would make the following suggestions:

A. MERGER CANDIDATES

1. Advocacy and Minority Small Business

2. Procurement and 8A

3. Finance and Investment (they already may be merged).

B. PRIVATIZATION CANDIDATES

1. Management Assistance

2. 7a Lending (further delegation only).

C. ELIMINATION CANDIDATES

1. All direct lending.

In 1978 the Congress directed the Small Business Administration to hold a White House conference on small business in 1980. In order to consider topics that should be addressed at this conference, and also to address the direction of the agency, we had a meeting of all District directors, regional directors and top managers of the SBA at Newport Rhode Island. One of the things we did at that conference was to evaluate each program of the SBA and each attendee was required to list in descending order the importance of each of SBAs programs. I remember that advocacy came in first, or most important but I can't recall the standing of the other SBA programs. Perhaps it would be interesting to go back and look at the minutes of that meeting and find out how we ranked each of the SBA programs back in 1978.

I would like to spend the remainder of my time discussing the perception that SBA loans involve too much bureaucratic red tape.

After I left the SBA in 1981 I returned to the Investment Banking business. In the mid 1980s I was asked to spend six months at a medium size bank holding company, where my task was to increase their SBA guaranteed loans. I began by interviewing each of the approximately 60 loan officers. Almost to a person they were convinced that the paper work and other bureaucratic red tape required by the SBA was simply so difficult that they didn't bother to even try to put SBA guaranties on any of their loans. I examined some representative loan files that were not guaranteed by the SBA but which would have been eligible for such guarantee. Going through those files was a revelation to me. In virtually all cases important and material documents were missing or improperly filled out. Sometimes there wasn't even a signed note. Sometimes there was not a financial statement on the company to whom the loan was made. In virtually no case were annual financial statements filed on loans that were outstanding, as was required. When insurance policies were used as collateral, in many cases there was no assignments of such insurance. The bottom line was that many of the loans I examined would not have stood up in court if the attempt were made to

foreclose them, simply because essential documentation was not in the files. After more meetings with the loan officers and conferences with the Bank's top officials we concluded that there simply was not any documentation required by the Small Business Administration that a prudent banker should not require in the first place and I'm sure that this is still true. The other complaint that was often heard was the length of time it took to approve a SBA loan. While I was at SBA we initiated the Certified Bank Program which under certain conditions permitted the banks to make their own decisions regarding loans. This bank had simply not been using its authority. We conferred with the local SBA office and they agreed to process properly documented loans within three business days, as provided by the Preferred Lenders Program of the Certified Bank Program. We also found that virtually none of the loans which had been made (and there were a few) had been sold in the secondary market... so I asked for some time at the loan committee meetings and explained to the loan officers and to other officers of the bank what the advantages are to the bank of selling SBA guaranteed loan portions in the secondary market. (I will not take the time of the committee to give an example but would be delighted to do so if asked.) We then approached the State Pension Plan and succeeded in getting its administrators to agree to buy up to $100 million of SBA guaranteed portions at

a 2.5% premium, as soon as the SBA guarantee was issued. In a period of about 5 months the bank made over 150 SBA loans with the SBA guarantee, and sold everyone of them in the secondary market for a total of almost $50 million with a premium of more than $1 million. When my six months was up at the bank I left. At this time this bank is not making loans at the same pace, but it remains a good SBA guaranteed lender. What I am trying to demonstrate by the above story is that any bank which undertakes a structured program to increase SBA lending, can, with proper supervision, not only greatly benefit the small business community by making loans that the otherwise would not make, but they also increase the profits of the bank by selling these loans in the secondary market. Additionally, they can dampen the losses that the bank otherwise would have had, clean up their files, get their documentation in order and add to the bottom line of the bank. I know that this program will work because I have done it.

I have spent my time rebutting false perceptions about the SBA because I believe that you will hear each of them from those who seek to eliminate the agency. Former Administrator Foley presented a more positive story and I believe that Mr. Baldwin and former Administrator Sanders will do the same. Let me close by saying that my belief is that the efforts of the Federal Trade

Commission to preserve competition and the SBA to promote and assist small business are two of the most positive elements of the Federal Government.

I will be pleased to answer any questions that the committee members wish to ask.

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ASSISTANT TO THE CHAIRMAN OF THE BOARD, STEPHENS, INC.
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Mr. Weaver is a registered principal and has directed several companies owned by and affiliated with Stephens, Inc. As President and Chief Executive Officer of Stephens Overseas Services, Mr. Weaver directed financial institutions, jointly owned by Stephens, Inc. and an Asian partner, in Hong Kong, Taiwan, Singapore and Indonesia. He also supervised the international operations of Stephens, Inc. in Germany, France and Great Britian. In 1984-85 he acted as a consultant to the British Delegation to the European Economic Community. Mr. Weaver currently represents Stephens, Inc. and its affiliates in Washington, D.C.

ADMINISTRATOR, UNITED STATES SMALL BUSINESS ADMINISTRATION
1977-1981

Mr. Weaver supported passage of civil service reforms, and, under his direction, SBA was the first government entity to implement civil service reform. Mr. Weaver pushed for passage of legislation to reorganize minority and disadvantaged business opportunities (P.L. 95-507) and initiated the Certified Bank Program, which transferred administration of government-guaranteed small business loans form SBA to certified private banks. During 1979-80, he organized and supervised the highly successful White House Conference on Small Business.

Mr. Weaver's knowledge of government stems from 15 years of working with administrative agencies and Congress. He is respected on Capitol Hill for his knowledge of all aspects of the authorization, budget, appropriation, and reconciliation processes.

PRESIDENT AND CHIEF EXECUTIVE OFFICER, UNION LIFE INSURANCE CO.
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Under Mr. Weaver's leadership, Union Life attained a rating of A+, the highest rating assigned, from Best's Insurance Reports.

REGISTERED REPRESENTATIVE, STEPHENS, INC.
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ISBN 0-16-047619-4

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